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SURVEYS

DECEIVED BY DISPARITY STUDIES: WHY THE TENTH CIRCUIT FAILED TO APPLY *CROSON*'S STRICT SCRUTINY STANDARD IN *CONCRETE WORKS OF COLORADO*

INTRODUCTION

Many state and local governments across the country, including the City and County of Denver, utilize affirmative action programs that strive to increase Minority Business Enterprise ("MBE") participation in government construction and professional design projects. In *City of Richmond v. J.A. Croson Co.*,[1] the Supreme Court held that such race-based programs must pass strict scrutiny analysis.[2] The Court found that the City of Richmond's MBE program did not withstand strict scrutiny, and, thus, invalidated the program as violating the Equal Protection clause of the Fourteenth Amendment.[3]

In light of the *Croson* decision, many local governments eliminated or modified their MBE programs because of constitutional concerns.[4] In an effort to defend their MBE programs, some governments commenced statistical studies to help pass *Croson*'s strict scrutiny analysis.[5] This reaction is based on language in *Croson* stating: "[w]here there is a significant statistical disparity between the number of qualified minority contractors willing and able to perform a particular service and the number of such contractors actually engaged by the locality or the locality's prime contractors, an inference of discriminatory exclusion could arise."[6]

Governments also look to anecdotal evidence to supplement the statistical evidence in disparity studies.[7] In *Croson*, the Court reasoned that anecdotal evidence, "if supported by appropriate statistical proof," can support a government's contention that broad remedial relief is necessary.[8] Anecdotal evidence can show that discrimination is the underlying cause of disparate statistics, rather than some other race-neutral cause.[9]

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1. 488 U.S. 469 (1989).
2. *Croson*, 488 U.S. at 494-95. Strict scrutiny requirements are discussed *infra* notes 31-56 and accompanying text.
3. *Id.* at 511.
4. Jeffrey M. Hanson, *Hanging by Yarns?: Deficiencies in Anecdotal Evidence Threaten the Survival of Race-Based Preference Programs for Public Contracting*, 88 CORNELL L. REV. 1433, 1444 (2003).
5. *Id.* at 1444-45.
6. *Id.* at 1444 (quoting *Croson*, 488 U.S. at 509).
7. *Id.* at 1447-48.
8. *Id.* at 1448 (quoting *Croson*, 488 U.S. at 509).
9. *Id.* at 1448-49.

Reacting to *Croson*, the City and County of Denver ("Denver") conducted in-depth statistical studies to support its MBE program.[10] Concrete Works of Colorado ("CWC") challenged Denver's affirmative action ordinance, claiming that it violated the Equal Protection Clause of the Fourteenth Amendment.[11]

This Survey discusses affirmative action programs as applied to public contracting, and the requirements promulgated by the Supreme Court to pass strict scrutiny analysis. Part I explains the emergence of judicial strict scrutiny as the standard for government race-conscious programs. Part I also discusses the Tenth Circuit's decision in *Concrete Works* and the facts supporting its decision. In Part II, this survey discusses the Third and Eleventh Circuit's application of strict scrutiny. Part III examines Justice Scalia's reaction to the Supreme Court's denial of certiorari for *Concrete Works*. Part IV analyzes the strict scrutiny standard promulgated by the Supreme Court in *Croson*, and assesses whether or not the Tenth Circuit adhered to that standard. Additionally, Part IV addresses Justice Scalia's criticisms of the Tenth Circuit, as well as the Third and Eleventh Circuit's application of strict scrutiny.

I. STRICT SCRUTINY: THE TEST FOR GOVERNMENT AFFIRMATIVE ACTION PROGRAMS

A. J.A. Croson Co. v. City of Richmond[12]

Croson stands as the seminal case establishing strict scrutiny as the test for racial classifications benefiting minorities.[13] Prior to 1989, when *Croson* was decided, no binding jurisprudence existed regarding the level of scrutiny for government affirmative action programs.[14]

1. Facts

In *Croson*, the Richmond City Council ("the City Council") adopted the Minority Business Utilization Plan ("the Plan"), which required prime contractors to subcontract at least 30% of their contract amount to one or more MBEs.[15] An MBE was defined as a "business at least fifty-one (51) percent of which is owned and controlled . . . by minority group members."[16] The Plan defined "minority group members" as "citizens of the United States who are Blacks, Spanish-speaking, Orientals, Indians, Eskimos, or Aleuts."[17] The City Council declared the Plan to be remedial

10. *See* Concrete Works of Colo., Inc. v. City & County of Denver, 321 F.3d 950, 962-69 (10th Cir. 2003).
11. *Concrete Works*, 321 F.3d at 957.
12. 488 U.S. 469 (1989)
13. ERWIN CHEMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 706 (2d ed. 2002).
14. *See id.*
15. *Croson*, 488 U.S at 477.
16. *Id.* at 478.
17. *Id.*

in nature with the purpose of "promoting wider participation by minority business enterprises in the construction of public projects."[18]

Additionally, the Plan authorized waivers to contractors who made "every feasible attempt" to comply with the 30% set-aside requirement but could not.[19] The waivers could only be granted in exceptional circumstances and contractors were required to demonstrate that "qualified Minority Business Enterprises . . . [were] unavailable or unwilling to participate in the contract to enable meeting the 30% MBE goal."[20]

The City Council adopted the Plan after holding a public hearing.[21] Plan proponents relied upon a study indicating that, while Blacks constituted 50% of Richmond's general population, the city awarded only 0.67% of prime construction contracts to MBEs during a five year period.[22] The City Council also relied upon oral statements made at the public hearing claiming that discrimination existed in the construction industry both nationally and locally.[23] Notwithstanding the study and anecdotal statements, the city failed to present any direct evidence indicating it had participated in race discrimination, or that prime contractors had discriminated against MBEs.[24]

After the Plan's adoption, Richmond issued an invitation to bid on the installation of plumbing fixtures for the city jail, and J.A. Croson Company ("Croson"), a prime contractor, received the project bid forms.[25] Despite Croson's efforts to procure bids from MBEs, no MBE expressed an interest in the project until the day the bid was due, when Croson secured an MBE for the project.[26]

However, the MBE was unable to obtain credit and, therefore, submitted a bid to Croson that would have caused the entire project to exceed the proposed budget.[27] As a result, Croson applied for a waiver.[28] Richmond denied Croson's request for a waiver and decided to re-bid the project.[29] Consequently, Croson brought an action against Richmond under 42 U.S.C. § 1983, claiming the Plan was unconstitutional on its face, and in its application, for violating the Equal Protection Clause of the Fourteenth Amendment.[30]

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18. *Id.*
19. *Id.*
20. *Id.* at 478-79.
21. *Id.* at 479.
22. *Id.* at 479-80.
23. *Id.* at 480.
24. *Id.*
25. *Id.* at 481.
26. *Id.* at 482.
27. *Id.* at 482-83.
28. *Id.* at 482.
29. *Id.* at 483.
30. *Id.*

2. Decision

The Court in *Croson* established the constitutional standards to which affirmative action programs are subject. Specifically, the Court held that a government must present a "strong basis in evidence"[31] that a program is "narrowly tailored"[32] to serve a "compelling interest."[33]

The Plan failed the compelling governmental interest prong of strict scrutiny analysis.[34] The Court reasoned that Richmond could satisfy the compelling governmental interest requirement if it demonstrated that it was a "passive participant" in a system of racial discrimination.[35] A government is a passive participant in racial discrimination when it uses public dollars to employ private firms that engage in discriminatory conduct.[36] The Court reasoned that all state and federal governments have a compelling interest to ensure that public tax dollars, which are drawn from all citizens, do not finance groups that participate in discriminatory conduct.[37]

However, no direct evidence existed that showed Richmond or prime contractors had discriminated against MBEs.[38] The Court held that a state must identify "discrimination, public or private, with some specificity before [it] may use race-conscious relief."[39] Richmond's attempt to use past societal discrimination as the basis for its affirmative action program would "open the door to competing claims for 'remedial relief' for every disadvantaged group."[40]

Furthermore, the Court determined that the statistics comparing Richmond's minority population to the percentage of prime contracts awarded to MBEs "had little or no probative value in establishing prior discrimination" in the construction industry.[41] The fact that Blacks constituted 50% of the city's general population, but only received 0.67% of the city's prime construction contracts, was nothing more than a "general population statistic."[42] The Court held that "when special qualifications are required to fill particular jobs, comparisons to the general population (rather than to the smaller group of individuals who possess the neces-

31. *Id.* at 500.
32. *Id.* at 506-07.
33. *Id.* at 505. This survey refers to the Court's two-part strict scrutiny test as composed of "two prongs": the first being compelling interest and the second narrow tailoring.
34. *Id.*
35. *Id.* at 492 ("[I]f the city could show that it had essentially become a 'passive participant' in a system of racial exclusion practiced by elements of the local construction industry, we think it clear that the city could take affirmative steps to dismantle such a system.").
36. *See id.* at 492-93.
37. *Id.*
38. *Id.* at 480.
39. *Id.* at 504.
40. *Id.* at 505.
41. *Id.* at 485 (citing J.A. Croson Co. v. City of Richmond, 822 F.2d 1355, 1358-59 (4th Cir. 1987) (*Croson II*)).
42. *Croson II*, 822 F.2d at 1358-59.

sary qualifications) may have little probative value,"[43] and such comparisons actually suggest the Plan was "more of a political than a remedial basis for the racial preference."[44]

The Plan also failed the narrow tailoring prong of strict scrutiny analysis.[45] A fatal flaw of the Plan was its over-inclusiveness,[46] as there was no evidence of "discrimination against Spanish-speaking, Oriental, Indian, Eskimo, or Aleut persons" in the local construction industry.[47] The Court reasoned that the "random inclusion" of additional racial groups indicated the Plan was not remedial in nature.[48] The Plan could not possibly serve a remedial purpose if a person of Aleut or Eskimo descent had never resided in Richmond.[49] In addition, the City Council chose the 30% set-aside figure arbitrarily, failing to show any relevance to the actual number of MBEs in Richmond, or to any other pertinent statistic.[50]

In the absence of evidence of specific instances of discrimination, the Court required Richmond to consider race-neutral alternatives before utilizing a race-based plan.[51] However, Richmond failed to consider the use of race-neutral means to increase MBE participation in city contracts.[52] The Court proffered an array of race-neutral means by which Richmond could increase MBE participation, including simplifying the bidding process, relaxing the bonding requirements, training, and offering financial assistance.[53]

The Plan in *Croson* was fatally flawed and did not withstand strict scrutiny. Richmond failed to produce valid statistical evidence concerning discrimination.[54] Thus, Richmond could not meet the compelling governmental interest requirement. Additionally, the arbitrary 30% requirement and the inclusion of extraneous racial groups demonstrated that the Plan was not narrowly tailored.[55] Significantly, the test set forth

43. *Croson*, 488 U.S. at 485 (quoting Hazelwood Sch. Dist. v. United States, 433 U.S. 299, 309 n.13 (1977)).

44. *Id.* at 485 (citing *Croson II*, 822 F.2d at 1359). The appeals court in *Croson II* explained that general population statistics failed to address the statistical disparity between the percentage of qualified minority business contractors doing business in the city and the percentage of bid funds awarded to those businesses. *Id.*

45. *Croson*, 488 U.S. at 507.

46. *Id.* at 506.

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.* at 499.

51. *Id.* at 509.

52. *Id.* at 507.

53. *Id.* at 509-10.

54. *Id.* at 505.

55. *Id.* at 507.

by the Court in *Croson* established that racial classifications benefiting minorities must withstand strict scrutiny analysis.[56]

B. *Tenth Circuit: Deciphering* Croson *in* Concrete Works of Colorado v. City and County of Denver[57]

1. Facts

In 1990, the City and County of Denver adopted an affirmative action program, codified as Ordinance No. 513 ("Ordinance").[58] The Ordinance applied to all city contracts in which a bid was required to receive a construction project.[59] The Ordinance required the utilization of MBEs and Women Business Enterprises ("WBEs") on construction projects with Denver.[60] The Ordinance defined MBEs as businesses: "(1) at least 51% owned by one or more eligible minorities and (2) with daily business operations controlled by one or more eligible minorities."[61] The Ordinance defined minorities as "persons of Black, Hispanic, Asian-American, or American Indian descent."[62] The Ordinance required that 16% of the annual dollar amount spent by Denver on construction contracts must be awarded to MBEs.[63]

Contractors and subcontractors who placed bids on Denver contracts were also required to comply with the Ordinance's criteria.[64] Contractors could comply with the Ordinance either by meeting the project participation goals or by demonstrating good faith efforts to meet the participation goals.[65] Under the Ordinance, contractors could meet the good faith exemption if they attempted to subcontract with MBEs but were unsuccessful.[66] A contractor could also demonstrate good faith efforts if he rejected an MBE because the MBE failed to submit the lowest bid or was unqualified.[67] If a contractor failed to meet the participation goals or the good faith requirement, Denver would consider the contractor's bid "not responsive."[68]

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56. *Id.* at 509.
57. 321 F.3d 950 (10th Cir. 2003).
58. *Concrete Works*, 321 F.3d at 956.
59. *Id.*
60. *Id.* For the purposes of this Survey, only MBE, and not WBE, programs are discussed. Race-based programs are subject to strict scrutiny, which is the focus of this Survey.
61. *Id.*
62. *Id.*
63. *Id.* The Ordinance was subsequently amended in 1996 and again in 1998. *Id.* The 1996 Ordinance expanded the scope of contracts that were covered by the 1999 Ordinance. *Id.* The 1998 Ordinance reduced the MBE participation goal from 16% to 10%. *Id.* at 956-57. For the purposes of this Survey, the 1996 and 1998 amendments have no effect on the strict scrutiny analysis. As such, this Survey's discussion is limited to the 1990 Ordinance.
64. *Id.* at 956.
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.*

Concrete Works of Colorado ("CWC"), a construction firm owned by a non-minority male, lost three contracts with Denver when it failed to comply with the MBE participation goals or meet the good faith requirements set forth in the Ordinance.[69] Consequently, CWC filed a complaint against Denver seeking damages and injunctive relief, claiming that the Ordinance violated the Equal Protection Clause of the Fourteenth Amendment.[70] After the district court ruled that the Ordinance violated the Equal Protection Clause, Denver appealed.[71]

2. Decision

a. Burden of Proof

The Tenth Circuit assessed the burden of proof Denver had to meet in order to uphold the constitutionality of the Ordinance.[72] According to the Tenth Circuit, Denver could satisfy its burden "without conclusively proving the existence of past or present racial discrimination."[73] Thus, Denver could proffer statistical and anecdotal evidence to demonstrate a disparity between the number of qualified minority contractors and the number of such contractors actually utilized by local prime contractors.[74] Moreover, Denver could meet its burden by "presenting evidence of its own direct participation in racial discrimination or its passive participation in private discrimination."[75]

Once Denver met its initial burden, CWC was required to "introduce 'credible, particularized evidence to rebut [Denver's] initial showing of . . . a compelling interest.'"[76] CWC could rebut Denver's statistical evidence "by (1) showing that the statistics [were] flawed; (2) demonstrating that the disparities shown by the statistics [were] not significant or actionable; or (3) presenting contrasting statistical data."[77] The court held that the burden of proof at all times remained with CWC to prove the unconstitutionality of the Ordinance.[78]

b. Statistical Evidence

The Tenth Circuit held that Denver demonstrated a compelling governmental interest by producing detailed statistical evidence.[79] Denver hired several independent research firms to conduct disparity studies in

69. *Id.* at 957.
70. *Id.*
71. *Id.*
72. *Id.* at 957-58.
73. *Id.* at 958.
74. *Id.*
75. *Id.*
76. *Id.* at 959 (quoting Adarand Constructors, Inc. v. Slater, 228 F.3d 1147, 1175 (10th Cir. 2000) (alteration in original)).
77. *Id.* (quoting Coral Constr. Co. v. King County, 941 F.2d 910, 921 (9th Cir. 1991)).
78. *Id.*
79. *Id.* at 990.

an effort to justify the Ordinance.[80] The studies created a disparity index by dividing the percentage of MBE participation in city contracts by the percentage of MBEs in the local construction population.[81] A disparity index of "one" indicated full MBE utilization, whereas an index closer to zero indicated underutilization of MBEs.[82] Such disparity indices showed a statistical underutilization of MBEs on Denver projects.[83]

The court further reasoned that an inference of discriminatory conduct could be drawn from statistical disparities.[84] Furthermore, Denver was not required to show that discriminatory conduct in the construction industry differed from societal discrimination.[85] The court determined that it was irrelevant for constitutional purposes whether industry discrimination was a result of societal discrimination or whether such discrimination was "the product of policies, practices, and attitudes unique to the industry."[86] Thus, the Tenth Circuit criticized the district court for erroneously requiring Denver to show that the existence of discriminatory conduct was more than a reflection of general societal discrimination.[87] Instead, Denver was only required to demonstrate a strong basis in evidence of discrimination, not *prove* discrimination.[88]

The court included additional reasons supporting its finding that Denver's statistical evidence was sufficient to satisfy the compelling governmental interest requirement. First, Denver's statistical evidence did not suffer from the same flaws as the evidence presented in *Croson*.[89] In *Croson*, Richmond's MBE program included racial groups that may never have experienced discrimination.[90] In *Concrete Works*, by contrast, Denver presented evidence of discrimination against each racial group included in the Ordinance.[91] However, Denver was not required to prove that each racial group experienced discrimination equally.[92] Secondly, the court relied on studies indicating that MBEs experienced difficulties obtaining financing and forming businesses.[93]

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80. *Id.* at 962.
81. *Id.*
82. *Id.*
83. *See id.* at 990-91. Denver hired numerous independent research firms to conduct multiple disparity studies. The disparity indices for MBEs varied, but were always less than one. *See id.* at 962-69.
84. *Id.* at 971.
85. *Id.* at 972.
86. *Id.*
87. *Id.* at 973.
88. *Id.* at 971. "Denver was under no burden to identify any specific practice or policy that resulted in discrimination." *Id.* at 972. Nor was Denver "required to demonstrate that the purpose of any such practice or policy was to disadvantage women or minorities." *Id.* Such a burden would be equivalent to "requiring direct proof." *Id.*
89. *Id.* at 971.
90. *Croson*, 488 U.S at 506.
91. *Concrete Works*, 321 F.3d at 971.
92. *See id.*
93. *Id.* at 979.

In challenging the statistical evidence presented by Denver, CWC highlighted one study in particular that failed to control for firm size and experience.[94] CWC asserted that the disparities shown in the studies could be attributable to firm size and lack of experience, rather than discrimination.[95] Thus, CWC argued, the disparities were inflated because the studies did not reflect MBEs that were actually "qualified, willing, and able to work on City projects."[96] The court rejected CWC's arguments that failure to control for firm size and experience invalidated Denver's statistical evidence.[97] The court reasoned that statistical evidence indicated that MBEs experienced lending discrimination and faced difficulties forming businesses.[98] Consequently, such discrimination *caused* MBEs to be smaller and less experienced.[99] Moreover, CWC did not conduct its own disparity study to rebut Denver's statistical findings.[100] Therefore, the court held that CWC did not meet its burden to discredit the evidence Denver presented.[101]

c. Anecdotal Evidence

Denver produced considerable anecdotal evidence that supported the claim that racial discrimination existed in the construction industry.[102] The evidence included testimony of an executive of a large non-minority owned construction firm, who stated that "he received credible complaints from minority and women-owned construction firms that they were subject to different work rules than majority-owned firms."[103] The executive also stated that he witnessed racial-based graffiti on job sites in the local area.[104] MBEs testified that they had difficulty in pre-qualifying for private sector projects and that their bids were rejected even when they were the lowest bidder.[105]

One study indicated that some Denver employees and private contractors attempted to circumvent the Ordinance goals.[106] Denver employees would create a "change order" to an existing contract, rather than create a new bid for work.[107] Employees also characterized some projects as "remodeling" instead of a construction project because remodels were not subject to the participation goals.[108] Finally, anecdotal evidence indi-

94. *Id.* at 980.
95. *Id.*
96. *Id.*
97. *Id.* at 981.
98. *Id.*
99. *Id.*
100. *Id.* at 982.
101. *Id.*
102. *Id.* at 969.
103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.* at 963.
107. *Id.*
108. *Id.*

cated that contractors would call WBEs that were out of business in an attempt to meet the good faith requirements.[109]

The court found that Denver's anecdotal evidence included "several incidents involving profoundly disturbing behavior," and that it revealed "behavior that was not merely sophomoric or insensitive, but which resulted in real economic or physical harm."[110] The court concluded that the anecdotal evidence provided "persuasive, unrebutted support for Denver's initial burden."[111]

When the Tenth Circuit weighed both the statistical and anecdotal evidence, it held that Denver had a compelling governmental interest in remedying racial discrimination in the construction industry.[112] In addition, CWC failed to rebut Denver's evidentiary showing. Thus, the court held that the Ordinance was constitutional and did not violate the Equal Protection Clause of the Fourteenth Amendment.[113]

II. HOW OTHER CIRCUITS HAVE APPLIED *CROSON'S* STRICT SCRUTINY STANDARD

A. *Third Circuit:* Contractors Ass'n of Eastern Pennsylvania, Inc. v. City of Philadelphia[114]

1. Facts

The City of Philadelphia implemented an affirmative action program that sought to increase participation of "disadvantaged business enterprises" (DBEs) in city construction contracts.[115] DBEs were defined as businesses "at least 51% owned by 'socially and economically disadvantaged' persons."[116] Racial minorities were included in the DBE cate-

109. *Id.* No anecdotal evidence was introduced that the same conduct took place with MBEs: the evidence indicated that only out-of-business WBEs were called in attempt to meet the good faith requirements. *Id.*

110. *Id.* at 989.

111. *Id.* at 990.

112. *Id.* at 992.

113. *See id.* at 994. The Tenth Circuit did not discuss the second prong of strict scrutiny: narrow tailoring. Shortly after CWC brought suit in 1992, Denver moved for summary judgment. *Id.* at 992. The United States District Court for the District of Colorado granted Denver's motion for summary judgment. *Id.* The court concluded that Denver established a compelling interest and that Denver's program was narrowly tailored. *Id.* The Tenth Circuit reversed the grant of summary judgment on the compelling interest issue and concluded that CWC had waived any challenge to the narrow tailoring decision reached by the district court. *Id.* Because CWC did not challenge the district court's conclusion with respect to narrow tailoring, the Tenth Circuit did not address the issue. *Id.*

114. 91 F.3d 586 (3d Cir. 1996).

115. *Contractors Ass'n*, 91 F.3d at 591.

116. *Id.*

gory and participation goals for MBEs were set at 15% of the total dollar amount spent by Philadelphia on construction-related projects.[117]

At trial, Philadelphia presented disparity indices that calculated the utilization of black construction firms.[118] Philadelphia's expert, Dr. Andrew F. Brimmer, calculated the "participation rate" by dividing the number of prime contracts awarded to MBEs by the total number of public contracts awarded.[119] Brimmer then calculated the "availability rate" by dividing the number of black construction firms in the Philadelphia metro area by the total number of black construction firms in the Philadelphia metro area.[120] Based on Brimmer's calculations, the disparity index of 22.5 indicated racial discrimination in the construction industry.[121]

In addition to the statistical analysis, Philadelphia produced a report from a former Philadelphia employee concerning the participation of MBEs on public works projects.[122] The employee, John Macklin, testified that he reviewed 25 to 30 percent of the project engineer logs, which tracked firm names that had participated in city projects.[123] Macklin relied on his personal memory to determine whether a firm in the log was an MBE.[124] When questioned whether it was possible that MBEs had participated in city construction projects, Macklin responded, "it is a very good possibility."[125]

Another witness introduced by Philadelphia testified that, in his opinion, black contractors were subject to racial discrimination in the construction industry.[126] However, the witness was unable to identify a specific instance of discriminatory conduct.[127]

2. Decision

The district court found that Brimmer's analysis, coupled with the anecdotal evidence, failed to demonstrate a compelling governmental interest.[128] Philadelphia demonstrated nothing more than a "generalized assertion" that discrimination in the construction industry occurred.[129]

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117. *Id.* at 591-92. The Third Circuit declared that portions of the program which required set-asides for women and non-black minority contractors were unconstitutional. *Id.* at 593-94. Thus, the focus of this case is on the constitutionality of the program as applied to black contractors. *Id.* at 594.

118. *Id.*

119. *Id.* at 595 n.9.

120. *Id.*

121. *Id.* at 594-95.

122. *Id.* at 600.

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.* at 600-01.

128. *Id.* at 601-02.

129. *Id.* at 609 (quoting City of Richmond v. J.A. Croson Co., 488 U.S. 469, 498 (1989)).

Moreover, Philadelphia failed to provide an evidentiary basis on which to infer that a program was required to redress racial discrimination.[130]

Brimmer's study did not take into account whether black construction firms were "qualified and willing" to perform city construction projects.[131] Additionally, the statistics in the study were derived from varying sources, and the study did not account for a neutral explanation for low utilization of MBEs.[132]

The court reasoned that, when a strong evidentiary basis is lacking, racial classifications are a form of racial politics. [133] Ultimately, however, the court said that the question of whether a strong basis in evidence existed was "a close call" and did not rule on the issue.[134] Instead, the court decided that the program did not satisfy the narrow tailoring prong and, thus, invalidated Philadelphia's race-based preference program for violating the Equal Protection clause of the Fourteenth Amendment.[135]

B. *Eleventh Circuit:* Engineering Contractors Ass'n of South Florida, Inc. v. Metropolitan Dade County[136]

1. Facts

The Eleventh Circuit used disparity studies to determine the constitutionality of Dade County's ("County") MBE program.[137] The program established set-aside requirements and participation goals for MBEs.[138] At trial, the County presented statistical studies that compared (1) the percentage of bidders that were MBEs; (2) the percentage of awardees that were MBEs; and (3) the proportion of County contract dollars that were awarded to MBEs.[139] The disparity index indicated an underutilization of MBEs in County construction contracts.[140] However, when the study controlled for firm size, most of the disparities were insignificant.[141] In other words, the disparities were explained by small firm size rather than by discriminatory conduct.[142]

In addition to insignificant disparities, the methodology used to calculate MBE participation was seriously flawed.[143] The County calculated MBE participation rates by dividing the dollar amount received by

130. *Id.*
131. *Id.* at 602-03.
132. *Id.* at 603.
133. *Id.* at 610.
134. *Id.* at 605.
135. *Id.* at 602.
136. 122 F.3d 895 (11th Cir. 1997).
137. *Eng'g Contractors Ass'n*, 122 F.3d at 911-24.
138. *Id.* at 901.
139. *Id.* at 912.
140. *Id.* at 916.
141. *Id.* at 917.
142. *Id.* at 918.
143. *Id.* at 920.

MBEs, by the total dollar amount received by construction companies, regardless of where the work occurred.[144] This calculation method would substantially decrease MBE participation rates.[145]

The County commissioned another study that "(1) compared construction business ownership rates of [MBEs] to those of [non-MBEs] and (2) analyzed disparities in personal income between [MBE and non-MBE] business owners."[146] The study found that minorities are less likely to own their own businesses than white males, and that MBEs in the construction industry earned less money than non-MBEs.[147] The study concluded that current and past discrimination caused disparities in construction business entry rates and caused the differential in income.[148] Despite the study's results, the court rejected the study's validity, citing the rationale in *Croson* that a disproportionate entrance of minorities to the construction industry does not conclusively mean that discrimination exists.[149] Furthermore, the study failed to consider firm size, which discredited the results.[150]

In addition to statistical evidence, the County introduced significant anecdotal evidence that revealed discrimination in County construction projects.[151] County employees testified concerning incidents that required MBEs to complete lengthy punch lists (lists that required work to be redone), when non-MBEs were not required to complete punch lists.[152] The employees also testified that MBEs had difficulty obtaining bonding and financing.[153] Additionally, MBEs testified regarding numerous incidents of discrimination while bidding for jobs and when dealing with project foremen.[154] Other MBEs that responded to a survey claimed that they faced countless instances of discrimination including difficulty obtaining financing and unfair performance evaluations.[155]

2. Decision

The court found that the anecdotal evidence painted a grim picture of racial discrimination in the construction industry.[156] However, anecdotal evidence is only persuasive if it is "combined with and reinforced by sufficiently probative statistical evidence."[157] The court conceded that

144. *Id.* at 919-20.
145. *Id.*
146. *Id.* at 921.
147. *Id.*
148. *Id.* at 922.
149. *Id.*
150. *Id.* at 923.
151. *Id.* at 924.
152. *Id.*
153. *Id.*
154. *Id.* at 925.
155. *Id.*
156. *Id.*
157. *Id.*

anecdotal evidence can show the perception of discrimination and can bolster statistical evidence.[158] The court further acknowledged that it could support a local government's determination that remedial relief in the form of a race-based program is warranted.[159] However, "[w]ithout the requisite statistical foundation for the anecdotal evidence to reinforce, supplement, support, and bolster . . ." no firm evidentiary basis existed to justify an MBE program.[160] Because the County's statistical foundation failed to show a strong basis in evidence, the anecdotal evidence was insufficient to meet the compelling governmental interest requirement.[161] Thus, the County's MBE program was unconstitutional as violating the Equal Protection Clause of the Fourteenth Amendment.[162]

III. JUSTICE SCALIA RESPONDS TO *CONCRETE WORKS* AND CLARIFIES THE STRICT SCRUTINY TEST

The Supreme Court denied the Tenth Circuit's petition for writ of certiorari.[163] Justice Scalia dissented from the denial of certiorari and attacked the Tenth Circuit's decision without constraint.[164] Scalia's arguments that criticize the Tenth Circuit are first, that the Tenth Circuit incorrectly allocated the burden of proof, and second, the statistics presented by Denver do not meet *Croson*'s strong basis in evidence standard.[165]

A. Burden of Proof

Scalia argues that the Tenth Circuit erroneously applied *Croson*'s burden of proof standard: "a proper plaintiff challenging governmental use of [affirmative action programs] can state a prima facie case simply by pointing to this practice and showing that he or she was treated unequally because of his or her race."[166] The burden of defending an affirmative action program then falls to the government, which must establish that it is remedying "identified discrimination" and that it "had a strong basis in evidence" to take remedial action.[167] However, the Tenth Circuit only required Denver to demonstrate "strong evidence from which an inference of past or present discrimination *could* be drawn."[168] The court then required CWC to "introduce credible, particularized evi-

158. *Id.* at 925-26.
159. *Id.* at 925.
160. *Id.* at 926.
161. *Id.*
162. *Id.* at 929. Although the County failed to demonstrate a compelling governmental interest, the court proceeded with a narrow tailoring discussion in an effort to complete the analysis of strict scrutiny. *Id.* at 926-29. The court found that the County's MBE program was not narrowly tailored and, thus, confirmed the district court's decision in finding the program unconstitutional. *Id.* at 929.
163. Concrete Works of Colo. v. City & County of Denver, 124 S. Ct. 556, 556 (2003).
164. *Concrete Works*, 124 S. Ct. at 556.
165. *Id.* at 557.
166. *Id.* (internal citations and quotation marks omitted).
167. *Id.* (internal citations and quotation marks omitted).
168. *Id.* at 558 (internal citations and quotation marks omitted).

dence to rebut Denver's initial showing of the existence of a compelling interest."[169] Scalia argues that Denver's burden was easily met, while CWC faced a "daunting task."[170] According to Scalia, "the Tenth Circuit got it exactly backwards."[171] When a contractor establishes that a government uses racial preferences, the government's conduct is presumed unconstitutional.[172] Thus, the *government* bears the burden to prove that "it is acting on the basis of a compelling interest in remedying racial discrimination."[173] Consequently, according to Scalia, the Tenth Circuit's erroneous burden of proof allocation had an outcome-determinative effect on *Concrete Works*.[174]

B. Statistical Evidence

Croson states that a government must show a "significant statistical disparity" between the number of contractors hired and "the number of *qualified* minority contractors *willing* and *able* to perform a particular service . . . ."[175] Scalia contends that Denver's statistical studies were inadequate because they failed to use actual bidding data.[176] In addition, the studies did not control for MBE qualifications, willingness, and availability.[177] Rather, Denver assumed that MBEs were as qualified, willing, and able as non-MBEs.[178] Scalia argues that Denver's studies incorrectly compared *all* MBEs, instead of *actual* MBEs who were "qualified, willing, and able."[179] Furthermore, Scalia argues that *Croson*'s standards should be fatal to affirmative action programs when a government's statistical evidence, such as Denver's, does not support its claim that the program is remedial in nature.[180]

Another significant flaw to Denver's statistical studies was the failure to control for firm size. Even if it was correct to assume that all MBEs were qualified, willing, and able, it was not proper to assume that all MBEs had an equal opportunity in obtaining city contracts as non-MBEs.[181] Scalia asserts that large construction firms posses a clear advantage over smaller firms in obtaining projects.[182] The evidence presented by Denver revealed that MBEs were, on average, smaller and less

169. *Id.* (internal citations and quotation marks omitted).
170. *Id.*
171. *Id.*
172. *Id.*
173. *Id.*
174. *See id.* at 558 ("Since Denver had to establish nothing more than the possibility of prior discrimination . . . the injured contractor was required to rebut the *possibility* of discrimination in the Denver construction industry.").
175. City of Richmond v. J.A. Croson Co., 488 U.S. 469, 509 (1989) (emphasis added).
176. *Concrete Works*, 124 S. Ct. at 558-59.
177. *Id.*
178. *Id.* at 559.
179. *Id.*
180. *Id.*
181. *Id.*
182. *Id.*

experienced than non-MBEs.[183] However, the Tenth Circuit concluded that MBEs were generally smaller and less experienced *because* of discrimination.[184] According to Scalia, "[t]he argument fails because it rests on nothing but speculation."[185] Denver's studies did not control for critical variables that would have provided a neutral explanation for underutilization of MBEs.[186]

Moreover, Denver introduced studies that showed disparities in MBE business formation rates and in access to capital.[187] Scalia asserts that disparities in these generalized areas would permit racial preferences in virtually every field of enterprise.[188] According to *Croson*, reliance upon such general societal discrimination "has no logical stopping point."[189] Race-neutral alternatives exist to combat lending and business formation barriers such as "prohibiting discrimination in the provision of credit . . . by local suppliers and banks."[190] Such lending discrimination does not give rise to a compelling state interest in remedying racial discrimination in the construction industry.

Scalia concluded his dissent by stating:

> If the evidence relied upon by governmental units . . . can be as inconclusive as Denver's evidence in this case, our former insistence upon a 'strong basis in evidence' has been abandoned, to be replaced by what amounts to an 'apparent-good-faith' requirement - that is, in the words of the Tenth Circuit, the existence of 'evidence from which an inference of past or present discrimination *could* be drawn.'[191]

"[T]he Court's decision to let this plain disregard of *Croson* stand invites speculation that that case has effectively been overruled."[192]

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183. Concrete Works of Colo. v. City & County of Denver, 321 F.3d 950, 981 (10th Cir. 2003).

184. *Concrete Works*, 321 F.3d at 981.

185. *Concrete Works*, 124 S. Ct. at 559.

186. *See id.* (discussing how the study did not address the relationship between minority ownership and size-and-experience).

187. *Id.*

188. *Id.*

189. *Croson*, 488 U.S. at 498 (quoting Wygant v. Jackson Bd. of Educ., 476 U.S 267, 275 (1986)).

190. *Concrete Works*, 124 S. Ct. at 560 (quoting *Croson*, 488 U.S. at 510).

191. *Id.* at 560-61.

192. *Id.* at 556. Scalia's statement that Croson has "effectively been overruled" is derived from the Court's denial of certiorari in *Concrete Works*, and the Court's recent decision in *Grutter v. Bollinger*, 123 S. Ct 2325 (2003). In *Grutter*, the Court gave much deference to the University of Michigan's educational judgment that "diversity is essential to its educational mission." *Grutter*, 123 S. Ct. at 2339. Scalia criticized the Court's willingness to rely upon good faith when it stated in *Grutter* that "[w]e take the Law School at its word that it would like nothing better than to find a race-neutral admissions formula and will terminate its race-conscious admissions program as soon as practicable." *Id.* at 2346 (internal quotation marks omitted).

IV. ANALYSIS

As set forth in *Croson*, government affirmative action programs are subject to strict scrutiny analysis.[193] A strong basis in evidence must exist for a government to show that its program is narrowly tailored to serve a compelling governmental interest.[194] Justice Scalia criticized the Tenth Circuit for allocating the burden of proof to the opponent of an affirmative action program. Scalia's other criticisms included the quality of Denver's statistical evidence and Denver's failure to consider race-neutral alternatives before implementing the Ordinance.[195] This analysis section will discuss Justice Scalia's criticisms of the Tenth Circuit's decision. In addition, this section will discuss the quality of statistics required to show a strong basis in evidence, and the role anecdotal evidence plays in supplementing statistical evidence.

A. Burden of Proof

Although *Croson* held that accurate statistics could create an inference of discrimination, the Court in *Croson* did not give specific guidance on issues such as which party bears the ultimate burden of proof under strict scrutiny analysis.[196] As such, courts are free to interpret *Croson*'s burden of proof requirement.[197]

In *Concrete Works*,[198] the Tenth Circuit discussed the burden of proof that each party was required to meet. The court stated that Denver could "meet its burden without conclusively proving the existence of past or present racial discrimination."[199] An ultimate judicial finding of discrimination was not required before Denver implemented its affirmative action program.[200] Thus, Denver was only required to present strong evidence from which an inference of past or present discrimination could be drawn.[201] The court defined strong evidence as that which "'approach[es] a prima facie case of a constitutional or statutory violation,' *not* irrefutable or definitive proof of discrimination"[202] Once Denver met its burden, CWC was required to introduce "credible, particularized evidence to rebut Denver's initial showing of the existence of a compelling interest."[203] The court held "that the burden of proof at all times remain[ed]

193. *See generally* City of Richmond v. J.A. Croson Co., 488 U.S. 469 (1989).
194. *Croson*, 488 U.S. at 500, 505-06.
195. See *supra* notes 163-192 at 20-23 and accompanying text.
196. Docia Rudley & Donna Hubbard, *What a Difference a Decade Makes: Judicial Response to State and Local Minority Business Set-Asides Ten Years After* City of Richmond v. J.A. Croson, 25 S. ILL. U. L.J. 39, 43 (2000) (discussing the burden of proof in strict scrutiny cases).
197. *Id.* at 43, 91.
198. Concrete Works of Colo., Inc. v. City & County of Denver, 321 F.3d 950 (10th Cir. 2003).
199. *Concrete Works*, 321 F.3d at 958.
200. *Id.* at 971.
201. *Id.*
202. *Id.* (quoting *Croson* 488 U.S. at 500).
203. *Concrete Works*, 321 F.3d at 959.

with CWC to demonstrate the unconstitutionality of the ordinances."[204] Because CWC did not sufficiently rebut Denver's statistical evidence, the court held that Denver met its burden in defending the constitutionality of its affirmative action program.[205]

Like the court in *Concrete Works*, the Third Circuit in *Contractors Ass'n*[206] held that the burden of proof rests with an opponent of an affirmative action program.[207] The court stated that "plaintiffs challenging [a] program retain the burden of persuading the district court that a violation of the Equal Protection Clause has occurred."[208] Additionally, the Third Circuit held that when a government produces facts that justify its affirmative action program, the plaintiff has the burden to show that the government's facts are inaccurate.[209]

Ordinarily, a government bears the burden of proof to show that its race-conscious program is necessary to achieve a compelling purpose.[210] Justice Scalia supports this proposition in his dissent by stating that it is "the *government's* burden to prove that it is acting on the basis of a compelling interest in remedying racial discrimination."[211] The distinction in Justice Scalia's interpretation and the Tenth and Third Circuit's interpretation of burden of proof lies in which party bears the *initial*, versus the *ultimate*, burden. The Tenth and Third Circuit allocated the initial burden of proof on the government and allocated the ultimate burden of proof on the challenging party.[212] Scalia argues that the ultimate burden of proof always rests with the government.[213] Scalia's arguments have merit, yet it is evident from *Croson* that a government at least bears the initial burden. In *Croson*, Justice O'Connor stated that "the purpose of strict scrutiny is to 'smoke out' illegitimate uses of race by assuring that the legislative body is pursuing a goal important enough to warrant use of a highly suspect tool."[214] Justice O'Connor's statement implies that a court must ensure that a government is using race-based programs in a legitimate manner. Thus, the Court is suggesting that a *government* has the burden of proof to show a strong basis in evidence.

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204. *Id.*
205. *Id.* at 991-92.
206. Contractors Ass'n of E. Pennsylvania v. City of Philadelphia, 91 F.3d 586 (3d Cir. 1996).
207. *Contractors Ass'n*, 91 F.3d at 597-98.
208. *Id.* at 597.
209. *Id.* at 598.
210. *See* CHEMERINSKY, *supra* note 13, at 520 (citing Miller v. Johnson, 515 U.S. 900, 919-21 (1995); Burson v. Freeman, 504 U.S. 191, 198 (1992)). Under rational basis review, the plaintiff has the burden of proving a program's unconstitutionality. *Id.* at 530.
211. Concrete Works of Colo., Inc. v. City & County of Denver, 124 S. Ct. 556, 558 (2003).
212. *Concrete Works*, 321 F.3d at 959; *Contractors Ass'n*, 91 F.3d at 598.
213. *Concrete Works*, 124 S. Ct. at 558.
214. *Croson*, 488 U.S. at 493.

B. What Constitutes a "Strong Basis in Evidence?"

Providing that a government bears the burden of proof to show a strong basis in evidence that an affirmative action program is necessary, uncertainty exists regarding the adequacy of evidence required to meet such a burden. *Croson* held that "where gross statistical disparities can be shown, they alone in a proper case may constitute prima facie proof of a pattern or practice of discrimination."[215] Accordingly, one could interpret *Croson* as requiring a government to produce prima facie evidence, or evidence that raises an inference of discrimination as sufficient to meet the burden of proof requirement. In contrast, Justice Scalia asserted that a government must "*prove* that it is acting on the basis of a compelling interest in remedying racial discrimination."[216] Scalia cites *Croson* when he states that a government must identify discrimination "with some specificity before [it] may use race-conscious relief."[217] Scalia equates "some specificity" with absolute proof and contends that an inference of discrimination is inadequate.[218] Although Scalia's arguments have merit, *Croson* did not expressly hold that a government must provide conclusive proof of discrimination.[219] Rather, the *Croson* Court stated that prima facie proof was sufficient to show a strong basis in evidence.[220]

In *Concrete Works*, Denver conducted in depth disparity studies in an effort to show a strong basis in evidence and support its affirmative action program.[221] However, its statistics were flawed, glossing over variables such as firm availability and firm size that would have invalidated the Ordinance.[222] A variable such as firm availability is crucial to a good disparity study.[223] "If availability is miscalculated, then all subsequent interpretations of statistics, including disparity ratios, will be in error."[224] In effect, an erroneous "availability analysis can make a Croson disparity study worthless."[225] Denver's studies calculated a disparity index by dividing the number of MBEs that participated in city projects by

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215. *Id.* at 501. Such statistical disparity, however, would be of no probative value if it compared the number of contracts awarded to MBEs to the general minority population. *See id.* Instead, a study must compare the number of contracts awarded to MBEs to a smaller group of MBEs that possess special qualifications to perform the jobs. *See id.* at 501-02.

216. *Concrete Works*, 124 S. Ct. at 558 (emphasis added).

217. *Id.* (quoting *Croson*, 488 U.S. at 504).

218. *Concrete Works*, 124 S. Ct. at 558.

219. *Croson*, 488 U.S. at 500.

220. *See id.* at 500-01. "Where gross statistical disparities can be shown, they alone in a proper case may constitute prima facie proof of a pattern or practice of discrimination." *Id.* at 501. (quoting Hazelwood Sch. Dist. v. U.S., 433 U.S. 299, 307-08 (1977)).

221. *Concrete Works*, 321 F.3d at 962-69.

222. *Id.* at 962, 980-82.

223. George R. LaNoue, *Standards for the Second Generation of Croson-Inspired Disparity Studies*, 26 URB. LAW. 485, 490 (1994). George LaNoue holds a Ph.D. and M.A from Yale University and is the Director of Policy Sciences at the University of Maryland Graduate School.

224. *Id.*

225. George R. LaNoue, *Who Counts?: Determining the Availability of Minority Businesses for Public Contracting After* Croson, 21 HARV. J.L & PUB. POL'Y 793, 799 (1998).

the total number of MBEs in the local construction market.[226] Such a "headcount approach" overstated the availability of MBEs because the studies did not control for MBEs that were "qualified, willing, and able" to work on city projects.[227] MBEs are generally smaller and less experienced than non-MBEs.[228] As a result, MBE participation rates on city projects would be less than non-MBE participation because they are typically less qualified and less able to undertake city construction projects.[229]

The Tenth Circuit assumed that MBEs were "smaller and less experienced *because* of industry discrimination."[230] However, the court did not support this statement with any statistical evidence. The court asserted that small firm size and experience were not race-neutral factors, as CWC attempted to argue.[231] As discussed *supra*, an accurate statistical study "requires careful measurement of appropriate variables."[232] The Tenth Circuit's assumptions, without underlying statistical support, scarcely qualify as a careful measurement.[233]

Denver relied on additional studies showing that MBEs faced discrimination when they sought to obtain credit and financing.[234] Denver argued that lending discrimination caused MBEs to experience barriers to business formation from the outset.[235] Thus, the studies indicated that Denver was a passive participant by employing firms that discriminated against MBEs.[236]

Provided that MBEs actually faced lending discrimination as Denver suggested, *Croson* expressly held that a government must consider race-neutral means before it may implement an affirmative action program.[237] The *Croson* Court offered numerous race-neutral means by which a government could combat financial discrimination, such as relaxed bonding requirements, increased training, and financial assistance.[238] The Tenth Circuit assumed that only MBEs faced barriers to business formation. As stated in *Croson*, "[m]any of the formal barriers to new entrants may be the product of bureaucratic inertia."[239] Thus, it

226. *Concrete Works*, 321 F.3d at 962.
227. LaNoue, *supra* note 223, at 799-800.
228. *Id.*
229. *Id.*
230. *Concrete Works*, 321 F.3d at 981.
231. *Id.*
232. LaNoue, *supra* note 223, at 795.
233. *Id.*
234. *Concrete Works*, 321 F.3d at 977-78.
235. *Id.* at 977.
236. *Id.*
237. *Croson*, 488 U.S. at 507.
238. *Id.* at 509-10. The Court suggested that the city of Richmond should attempt to increase city contracting opportunities to small businesses of all races by simplifying bidding procedures and prohibiting discrimination by local banks in their provision of credit and bonding. *Id.*
239. *Id.* at 510.

does not follow that barriers to business formation required Denver to implement an affirmative action program. Many new businesses, regardless of their racial composition, face a multitude of obstacles. As such, an affirmative action program is unwarranted when barriers to business formation are experienced by MBEs and non-MBEs alike. Despite the flaws in Denver's statistical studies, the Tenth Circuit held that Denver met its initial burden of showing a strong basis in evidence that discrimination existed in the Denver construction industry.[240]

In contrast, the Third Circuit in *Contractors Ass'n* held that Philadelphia's evidence failed to meet the strong basis in evidence requirement.[241] Philadelphia's studies did not take into account whether MBEs were qualified and willing to perform city construction projects.[242] In addition, the studies did not account for any neutral explanations of low MBE utilization.[243] Accordingly, the court held that there was no strong basis in evidence to support Philadelphia's affirmative action program.[244] The Third Circuit correctly invalidated Philadelphia's affirmative action program because *Croson* required that a disparity study should take into account only firms that were qualified, willing, and able to perform a particular service.[245]

Similarly, in *Engineering Contractors*,[246] the Eleventh Circuit invalidated Dade County's MBE program because a strong basis in evidence did not exist.[247] Unlike in *Concrete Works*, Dade County accounted for MBE size.[248] When the study controlled for this variable, the results indicated that low MBE utilization could be attributed to size, rather than to discrimination.[249] In addition, studies indicating that minorities formed businesses at a lesser rate than non-MBEs did not conclusively prove that discrimination existed. The Third Circuit correctly concluded that Dade County's evidence was insufficient to justify an affirmative action program.[250]

The Tenth Circuit relied on statistics that failed to live up to *Croson*'s strong basis in evidence requirement. Denver's studies were seriously flawed because they: (1) failed to control for firm size and experience; (2) overestimated MBE participation rates by including all MBEs,

240. *Concrete Works*, 321 F.3d at 991.
241. *Contractors Ass'n*, 91 F.3d at 601.
242. *Id.* at 602-03.
243. *Id.* at 603.
244. *Id.* at 609-10.
245. *Croson*, 488 U.S. at 509.
246. Eng'g Contractors Ass'n of S. Florida Inc. v. Metro. Dade County, 122 F.3d 895 (11th Cir. 1997).
247. *Eng'g Contractors*, 122 F.3d at 926.
248. *Id.* at 917.
249. *Id.*
250. *Id.* at 926.

not just those that were qualified, willing, and able; and (3) made assumptions regarding discrimination in the lending industry.[251]

The Third and Eleventh Circuits differed in their outcomes because they required accurate, reliable statistics to show a strong basis in evidence. Unlike the Tenth Circuit, they did not dismiss variables such as firm size and experience, simply because such variables would have invalidated the governments' programs. The Third and Eleventh Circuits correctly applied *Croson*'s strong basis in evidence requirement to show a compelling governmental interest. Despite flaws in Denver's statistics for failing to control for firm size and availability, the Tenth Circuit found that a strong basis in evidence existed. As Justice Scalia argued, "[i]f the evidence relied upon by governmental units to justify their use of racial classifications can be as inconclusive as Denver's evidence in this case, our former insistence upon a strong basis in evidence has been abandoned."[252]

C. *The Role of Anecdotal Evidence in Finding a Strong Basis in Evidence*

The Tenth Circuit, in addition to the Third and Eleventh Circuits, weighed anecdotal evidence when determining whether a strong basis in evidence existed. Although the anecdotal evidence presented in *Engineering Contractors* was disconcerting, the Eleventh Circuit reasoned that such evidence was persuasive only if combined with sufficiently probative statistical evidence.[253] In contrast, the Tenth Circuit found that Denver's anecdotal evidence provided "persuasive, unrebutted support for [its] initial burden."[254] According to *Croson*, a proper statistical foundation is crucial in meeting the strong basis in evidence requirement.[255] Thus, without an accurate statistical foundation, anecdotal evidence is ineffective to support a firm evidentiary basis on which to justify an MBE program.[256] Because it is difficult to verify whether anecdotal evidence is "remembered, perceived, or reported accurately," such evidence should be treated cautiously and must be supported by reliable statistics.[257] In *Concrete Works*, Denver's statistical studies were flawed and did not provide a strong basis in evidence.[258] Therefore, a statistical foundation was lacking in *Concrete Works*, yet the Tenth Circuit gave Denver's anecdotal evidence a great deal of deference in concluding that

251. *Concrete Works*, 321 F.3d at 962, 977, 982; *see also* LaNoue, *supra* note 223, at 799 (stating that "a defective availability analysis can make a Croson disparity study worthless").

252. *Concrete Works*, 124 S. Ct. 556, 560-61.

253. *Eng'g Contractors*, 122 F.3d at 925.

254. *Concrete Works*, 321 F.3d at 990.

255. *Croson*, 488 U.S. at 501.

256. *Eng'g Contractors*, 122 F.3d at 926. ("Without the requisite statistical foundation for the anecdotal evidence to reinforce, supplement, support, and bolster," no firm evidentiary basis exists to justify an MBE program).

257. LaNoue, *supra* note 223, at 525.

258. *See Concrete Works*, 321 F.3d at 962, 977, 982.

Denver had met its burden.[259] Because Denver's statistical studies did not meet *Croson's* rigid standards, the Tenth Circuit's treatment of anecdotal evidence was unwarranted.

V. CONCLUSION

Government affirmative action programs are subject to strict scrutiny analysis, which is the most intensive type of judicial review.[260] Strict scrutiny requires that a government provide a strong basis in evidence to show that a program is narrowly tailored to serve a compelling governmental interest. To uphold *Croson*'s rigid standards, courts must require governments to conduct statistical studies that accurately control for firm size, experience, and other variables that may provide a race-neutral explanation for disparate statistics. Without such reliable statistical studies, a government should not be able to satisfy the strong basis in evidence standard.

The Tenth Circuit attempted to apply *Croson*'s strict scrutiny analysis, but fell short. Denver's statistics were seriously flawed and, thus, were insufficient to establish a strong basis in evidence. If Denver's studies controlled for variables such as firm size and experience, its statistics would have been more convincing. Other circuits, such as the Third and Eleventh, are upholding the Supreme Court's strict scrutiny standards by requiring governments to produce accurate, thorough statistics that show a strong basis in evidence. If strict scrutiny provides a means to "smoke out" illegitimate uses of racial classifications, decisions such as the Tenth Circuit's in Concrete Works will hinder the determination of "what classifications are 'benign' or 'remedial' and what classifications are in fact motivated by illegitimate notions of racial inferiority or simple racial politics."261 The Tenth Circuit buried strict scrutiny analysis in substandard statistical studies, and the search for its appropriate application will be extremely problematic if such statistics are the basis of future affirmative action programs.

*Teresa Lee Brown**

259. *Id.* at 989-90.
260. CHEMERINSKY, *supra* note 13, at 519.
261. City of Richmond v. J.A. Croson Co., 488 U.S. 469, 493 (1989).

* J.D. Candidate, 2005, University of Denver College of Law. I would like to thank my husband, Hoyt, for his infinite patience, support, and love.

ALTERNATIVE DISPUTE RESOLUTION: THE FEDERAL ARBITRATION ACT AND RESOLVING DISPUTES IN ARBITRATION VERSUS A COURT PROCEEDING

INTRODUCTION

Almost everyone enters into an agreement to arbitrate, whether aware of it or not. Arbitration clauses are now the standard method for resolving disputes in many consumer contracts, such as insurance, medical, and broker contracts. Standard arbitration agreements pose the quintessential question: when a dispute arises, and a person's competency to enter into the contract as a whole is challenged, is the arbitration agreement embedded within the contract enforceable?

With the passage of the Federal Arbitration Act ("FAA" or "Act") in 1925,[1] along with the federal government's power and authority to enforce the FAA, comes an emergent issue of determining when arbitration, rather than a court proceeding, must be used to resolve a dispute.[2] Due to arbitration provisions becoming more common in consumer contracts, many contract disputes, and accordingly many court opinions, will be based on the enforceability of arbitration agreements in years to come.[3] In fact, conflicting court decisions resolving arbitration agreements have been abundant since the enactment of the Act, and courts are still trying to reach a consistent pattern of uniformity to enforce arbitration provisions.[4]

The FAA establishes in Title 9 of the United States Code, Section 2, that "[a] written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising . . . shall be valid, irrevocable, and enforce-

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1 United States Arbitration Act, ch. 213, § 1, 43 Stat. 883, 883-86 (1925) (currently codified at 9 U.S.C. §§ 1-16 (2000)). Congress later renamed the United States Arbitration Act the Federal Arbitration Act and enacted it into law on July 30, 1947, ch. 392, § 1, 61 Stat. 674.

2. *See* Steven Shavell, *Alternative Dispute Resolution: An Economic Analysis*, 24 J. LEGAL STUD. 1, 1-3 (1995) (discussing the widespread use of alternative dispute resolution ("ADR") in resolving contract disputes and problems that arise); *see also* Spahr v. Secco, 330 F.3d 1266, 1273 (10th Cir. 2003) (holding the plaintiff's mental incapacity invalidated the entire contract as well as the embedded arbitration clause); Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395, 406-07 (1967) (holding that a claim of fraud in the inducement of the entire contract is a matter for arbitration, and not the court, when the contract contains a valid arbitration clause).

3. *See* Maureen A. Weston, *Checks on Participant Conduct in Compulsory ADR: Reconciling the Tension in the Need for Good-Faith Participation, Autonomy, and Confidentiality*, 76 IND. L.J. 591, 593-97 (2001) (discussing the widespread use of arbitration clauses in consumer and employment contracts and the potential for misconduct and abuse in the ADR process because of the participants' lack of good faith and the absence of judicial oversight or regulation).

4. David P. Pierce, *The Federal Arbitration Act: Conflicting Interpretations of Its Scope*, 61 U. CIN. L. REV. 623, 623-24 (1992) (discussing conflicting interpretations of the FAA in various state decisions).

able, save upon such grounds as exist at law or in equity for the revocation of any contract."[5] Additionally, Section 4 states that if a contract with an arbitration provision has been entered into, and the "making" of the arbitration agreement is not at issue, the court shall order the parties to proceed to arbitration.[6] Thus, many issues arise when an arbitration provision is placed in a contract because the agreement to arbitrate is made "valid, irrevocable, and enforceable," by federal statute, which can only become unenforceable under the same theories as a contract may become unenforceable under contract law.[7] Since the adoption of the FAA, arbitration agreements are increasingly used in resolving disputes that arise out of the contract as a whole, which undoubtedly favors businesses over consumers.[8]

This survey paper[9] explores the Tenth Circuit Court of Appeals opinion in *Spahr v. Secco*,[10] where the court decided that a mental capacity claim challenging the validity of a contract containing an arbitration agreement should be resolved in a court proceeding instead of arbitration.[11] Prior to *Spahr*, the Tenth Circuit had not addressed this issue.[12] Other circuits, however, have decided cases similar to *Spahr*.[13] Although the outcome in *Spahr* is different from the outcome other circuits reached in similar cases,[14] the holding in *Spahr* is likely to have important implications on future court decisions because *Spahr* readily provides a logical, fair, and rational method of evaluating the enforceability of arbitration agreements.

If *Spahr* is appealed to the United States Supreme Court, however, the Tenth Circuit's holding in *Spahr* may be reversed because the Supreme Court will likely want to maintain uniformity in court decisions pursuant to the *Prima Paint* rationale.[15] In contrast, if the Court can find

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5. 9 U.S.C. § 2.
6. *Id.* § 4.
7. *Id.* § 2.
8. Edward A. Dauer, *Judicial Policing of Consumer Arbitration*, 1 PEPP. DISP. RESOL. L.J. 91, 94-96 (2000) (discussing the widespread use of ADR and the asymmetries of arbitration that favors businesses over consumers).
9. The survey period runs from September 1, 2002, to August 31, 2003.
10. 330 F.3d 1266 (10th Cir. 2003).
11. *Spahr*, 330 F.3d at 1273.
12. *Id.* at 1267-68.
13. *See* Primerica Life Ins. v. Brown, 304 F.3d 469, 472 (5th Cir. 2002) (finding that a mental capacity claim challenging a contract containing an arbitration clause should be decided in arbitration); Jeske v. Brooks, 875 F.2d 71, 75 (4th Cir. 1989) (concluding that claims of unconscionability and lack of consideration challenging a contract containing an arbitration clause should be decided in arbitration); Unionmutual Stock Life Ins. Co. of Am. v. Beneficial Life Ins., 774 F.2d 524, 529 (1st Cir. 1985) (concluding that claims of mutual mistake and frustration of purpose challenging a contract containing an arbitration clause should be decided in arbitration).
14. *See Spahr*, 330 F.3d at 1272-73.
15. *See* Southland Corp. v. Keating, 465 U.S. 1, 11-13 (1984); Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983). States are also overturning decisions to uphold the *Prima Paint* rationale and maintain consistent holdings. *See, e.g., Primerica Life Ins.*, 304 F.3d at 472 (concluding that a challenge to a contract containing an arbitration clause should be decided in arbitration in accordance with the *Prima Paint* rationale).

sufficient public policy reasons to support *Spahr*,[16] the Court may alter their *Prima Paint* decision and create a new standard for arbitration agreements that combine the *Prima Paint* and *Spahr* rationales. Should this occur, arbitration will undergo a change for the better because the decision in *Spahr* adds a logical and fair method of interpreting the FAA that gives arbitration agreements their intended effect.[17] Thus, combining the *Prima Paint* and *Spahr* rationale will provide an enhanced method of evaluating arbitration agreements that is both rational and maintains the national legislative goals of favoring arbitration.

Part I of this survey examines the background of the FAA by looking at its history and formation, as well as relevant FAA provisions. Part II of this survey analyzes the Tenth Circuit's recent decision in *Spahr v. U.S. Bancorp Investments, Inc.*, where the Tenth Circuit held the arbitration provision unenforceable. Part III of this survey examines other recent circuit court rulings in similar arbitration cases. Finally, this paper takes the position that *Spahr* properly held a mental capacity challenge to a contract containing an arbitration agreement goes to the "making" of the arbitration agreement, and thus should be determined in a court proceeding.[18]

I. BACKGROUND

A. History and Formation of the FAA

With the number of cases being litigated on the rise, Congress passed the FAA in 1925 to make arbitration an equitable alternative to litigation that would reduce the number of cases in the court system.[19] As a result of increasing national hostility towards arbitration and courts' refusal to enforce arbitration agreements in contracts, Congress codified the FAA in Title 9 of the United States Code in 1947 to underscore the fact that federal policy favors arbitration agreements.[20] This codification aimed to place arbitration provisions "'upon the same footing as other

16. *See* Weston, *supra* note 3, at 593-97; Dauer, *supra* note 8, at 95-96. Arguably public policy warrants changing the current rationale regarding consumer arbitration agreements because they asymmetrically favor businesses and do not provide a fair outcome for consumers; consumers are forced into arbitration agreements for which they have not bargained, and are denied their right to a jury trial.

17. *See* Larry J. Pittman, *The Federal Arbitration Act: The Supreme Court's Erroneous Statutory Interpretation, Stare Decisis, and a Proposal for Change*, 53 ALA. L. REV. 789, 791-92, 806-11, 889-90 (2002) (discussing the problems with the Court's current statutory interpretation of the FAA and how changing to an originalist mode of statutory interpretation would better suit legislative intent).

18. *Spahr*, 330 F.3d at 1273.

19. *See* Southland Corp. v. Keating, 465 U.S. 1, 13-16 (1984); *see also* Richard C. Reuben, *Public Justice: Toward a State Action Theory of Alternative Dispute Resolution*, 85 CAL. L. REV. 577, 601 (1997) (discussing the history of arbitration in the United States in the early twentieth century).

20. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24-25 (1991) (quoting Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983)).

contracts'" by allowing courts to invalidate arbitration agreements only for the same reasons that other contracts could be invalidated.[21]

Additionally, Congress intended the FAA to be applicable in federal courts and state courts, pursuant to the Supremacy Clause.[22] In *Southland Corp. v. Keating* and *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, the Supreme Court took the position that the FAA trumped state statutes regulating arbitration agreements, thereby invalidating conflicting state laws.[23] The Supreme Court, however, held that "state law may be applied '*if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.'"[24]

The Supreme Court has often reversed state court decisions that failed to enforce arbitration provisions in the same manner other contract provisions are enforced. In doing so, the Supreme Court has emphasized that they favor arbitration, pursuant to the legislative intent behind the Act.[25] By allowing state law to govern contracts generally, arbitration agreements are given the same standing and enforceability as other contracts because arbitration agreements are enforceable on the same grounds as any other contract.[26]

Arbitration is not inferior to litigation, but is simply a different method of resolving a dispute arising as "'a matter of contract,'"[27] in which a party is not required to arbitrate any dispute to which he has not agreed.[28] The Supreme Court has invalidated decisions where individual states refused to enforce arbitration provisions to the extent necessary to give those arbitration provisions the same enforceability as other contracts.[29]

The leading decision on the arbitrability of claims is *Prima Paint Corp. v. Flood & Conklin Mfg.*[30] In *Prima Paint*, the Supreme Court held that a claim for fraud in the inducement of the contract, which can invalidate the entire contract, instead of just the arbitration clause itself, should be resolved in arbitration.[31] The Court explained that unless there is concern that the claim involves the "making" of the arbitration provi-

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21. Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996) (quoting Scherk v. Alberto-Culver Co., 417 U.S. 506, 511 (1974) (citation omitted)).

22. *Southland*, 465 U.S. at 16.

23. *See id.*; *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24-25.

24. *Casarotto*, 517 U.S. at 686-87 (quoting Perry v. Thomas, 482 U.S. 483, 492 n.9 (1987)).

25. *See id.* at 687-88; *Gilmer*, 500 U.S. at 24-26; *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24-25.

26. *Casarotto*, 517 U.S. at 686-87.

27. AT&T Techs. Inc. v. Communications Workers of Am., 475 U.S. 643, 648 (1986) (quoting United Steelworkers of Am. v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582 (1960)).

28. *See* Reuben, *supra* note 19, at 605-07.

29. *See Casarotto*, 517 U.S. at 687; Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 275 (1995).

30. 388 U.S. 395 (1967).

31. *Prima Paint*, 388 U.S. at 406-07.

sion, Section 4 of the Act mandates the claim should be resolved by arbitration.[32]

Prima Paint also established the "separability doctrine," which severs arbitration clauses from the rest of the contract.[33] Where a claim does not attack the arbitration clause itself, but rather the entire contract, that claim must be resolved through arbitration.[34] This holding in *Prima Paint* may seem counterintuitive because a claim challenging the entire contract, including the making of the arbitration agreement, is subject to arbitration while a claim challenging only the arbitration agreement and not the entire contract may be resolved by the courts.[35] Although it may seem counterintuitive, *Prima Paint* established a rational and consistent pattern to determine which cases must be resolved by arbitration instead of by a court proceeding. Nonetheless, the *Prima Paint* rationale has been questioned because the holding reached by the Court arguably strayed from the FAA's language and legislative intent.[36] In so doing, the Court extended the FAA beyond cases involving interstate commerce and made arbitration agreements separable from the rest of the contract.[37]

Spahr v. Secco is a case of first impression in the Tenth Circuit[38] and will likely have a significant impact in determining when to mandate the arbitration of claims because *Spahr* adds a logical and fair method of interpreting the Act, even though it departs from *Prima Paint*. In sum, arbitration plays an important role in the litigation of consumer contracts. Moreover, conforming to uniform interpretations of the FAA is of great importance in future cases because uniformity will provide courts and consumers guidance in deciding whether to enter into or enforce contracts that contain arbitration agreements.

B. Relevant FAA Provisions

The key statutory provisions in the Act are Title 9 of the United States Code, Sections 2 through 4. Section 2 of the Act establishes that an arbitration provision is valid, irrevocable, and enforceable, but contains a "saving clause" allowing for an arbitration provision to be invali-

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32. *Id.* at 403-04.

33. *Id.* at 402-04.

34. *Id.* at 403-04; *see also* Tanya J. Monestier, *"Nothing Comes of Nothing" . . . Or Does It??? A Critical Re-Examination of the Doctrine of Separability in American Arbitration*, 12 AM. REV. INT'L ARB. 223, 224-27 (2001) (discussing the consistency with which U.S. case law has applied the *Prima Paint* severability doctrine to differentiate between contracts that are void and contracts that are voidable); Alan Scott Rau, *"The Arbitrability Question Itself,"* 10 AM. REV. INT'L ARB. 287, 331-36 (1999) (discussing misapplications of the *Prima Paint* doctrine).

35. *Prima Paint*, 388 U.S. at 403-04; *see also* Donald E. Johnson, *Has* Allied-Bruce Terminix Cos. v. Dobson *Exterminated Alabama's Anti-Arbitration Rule?*, 47 ALA. L. REV. 577, 609-10 (1996) (noting that although the rule in *Prima Paint* seems counterintuitive, it comports with the FAA).

36. *Prima Paint*, 388 U.S. at 407-08 (Black, J., dissenting). For further information on the legislative history of the FAA see the dissenting opinion.

37. *Id.* at 409-11 (Black, J., dissenting).

38. Spahr v. Secco, 330 F.3d 1266, 1267-68 (10th Cir. 2003).

dated under the standard contract defenses,[39] such as duress, fraud and unconscionability.[40] Section 3 of the FAA establishes that a court shall stay proceedings where the issue should be resolved in arbitration,[41] thereby limiting the court's authority to resolve disputes where the contract contains an arbitration provision.[42] Section 4 of the Act dictates when a court shall resolve a claim rather than requiring arbitration. This depends on whether the court is satisfied that the "making" of the agreement is not at issue.[43]

Section 2 of the FAA has been expanded to apply to state substantive and procedural policies in order to comply with the national policy favoring arbitration.[44] The Supreme Court progressively broadened the scope of cases to which the FAA extends by including contracts with arbitration agreements that do not involve interstate commerce.[45] The Supreme Court likewise interpreted Section 4 of the FAA to require that claims be arbitrated if the making of the arbitration agreement is not at issue.[46]

Section 4 of the Act is the key provision in many federal circuit cases because it allows a court to compel arbitration.[47] Section 4 of the FAA gives courts an opportunity to decide whether the claim goes to the

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39. *See* 9 U.S.C. § 2. Section 2 states in relevant part: "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *Id.*

40. *See Casarotto*, 517 U.S. at 687.

41. 9 U.S.C. § 3. Section 3 states:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Id.

42. *See, e.g.*, *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 26 (stating that both state and federal courts are obligated to stay litigation under Section 3).

43. 9 U.S.C. § 4. Section 4 in part states:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction . . . for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.

Id.

44. *Southland*, 465 U.S. at 10-16; *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24; *see Prima Paint*, 388 U.S. at 404-05.

45. *See Prima Paint*, 388 U.S. at 401.

46. *See id.* at 402-04.

47. *See Prima Paint*, 388 U.S. at 403; *Spahr*, 330 F.3d at 1270; Primerica Life Ins. v. Brown, 304 F.3d 469, 472 (5th Cir. 2002).

"making" of the arbitration agreement, and if so, that claim may be decided by the court instead of through arbitration.[48] By interpreting Section 4 of the FAA in a manner requiring arbitration of almost all claims brought under a contract containing an arbitration agreement, courts progressively broadened the scope of cases subject to the FAA. In doing so, these courts arguably exceeded the legislative intent because arbitration agreements have been given more influence and effect than other contracts.[49]

II. UNITED STATES COURTS OF APPEALS DECISIONS

A. The Tenth Circuit

1. *Spahr v. Secco*[50]

In a case of first impression, the Tenth Circuit decided in *Spahr* whether parties raising a mental capacity challenge to the validity of an entire contract should be required to arbitrate according to the contract, or instead go to a court proceeding.[51] This section of the paper discusses the Tenth Circuit Court of Appeals' decision in *Spahr*.

a. Facts

In *Spahr v. Secco*, Spahr, an elderly man affected by Alzheimer's and dementia opened an investment account with U.S. Bancorp Investments, Inc. (U.S. Bancorp), whereby Spahr signed an agreement "promising to submit any controversy arising out of the account to arbitration . . . ."[52] Secco was a female employee working for U.S. Bancorp as Spahr's broker, investment advisor, and trustee.[53] Secco allegedly exploited Spahr by using sex to finagle him "out of large sums of money and real estate."[54] When Spahr's estate filed claims against U.S. Bancorp and Secco to seek recovery, U.S. Bancorp filed a motion to compel arbitration, pursuant to the agreement Spahr signed.[55]

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48. *Prima Paint*, 388 U.S. at 403-04; *Spahr*, 330 F.3d at 1269-70; *Primerica Life Ins. Co.*, 304 F.3d at 472.

49. For a detailed examination of the legislative history of the FAA, see IAN R. MACNEIL, AMERICAN ARBITRATION LAW 83-121 (Oxford University Press 1992).

50. 330 F.3d 1266 (10th Cir. 2003).

51. *Spahr*, 330 F.3d at 1267-68.

52. *Id.* at 1268. The agreement in this case involves a Cash Account Agreement that stated:
I agree that any controversy arising out of or relating to my account, to transactions with or for me or to this agreement or the breach thereof, whether executed or to be executed within or outside of the United States, and whether asserted against broker-dealer and/or its present or former agents or employees, will be settled by arbitration before and in accordance with the then current rules of the National Association of Securities Dealers, Inc. [("NASD")].
Id.

53. *Id.*

54. *Id.*

55. *Id.*

The district court denied U.S. Bancorp's motion to compel arbitration, holding the agreement to arbitrate between Spahr and U.S. Bancorp was unenforceable because Spahr lacked the requisite mental capacity to comprehend the nature and effect of the contract.[56] U.S. Bancorp and Secco appealed the district court's decision, claiming Spahr's mental incompetence challenge to the agreement should never have been heard by the court and instead should have been resolved in arbitration.[57]

b. Decision

In *Spahr*, the Tenth Circuit Court of Appeals affirmed the district court's ruling that the agreement is not subject to the arbitration provision.[58] The Tenth Circuit explained that because Spahr lacked the mental capacity to contract, the claim was not subject to arbitration because the entire contract was void.[59]

The Tenth Circuit considered whether parties raising mental capacity claims challenging the validity of an entire contract should be required to arbitrate pursuant to the contract.[60] The court reviewed whether language in Section 4 of the FAA provides judicial relief to cases where the entire contract, including the arbitration agreement, is challenged.[61] In cases such as *Spahr*, where the making of the arbitration agreement is at issue, the court retains the power to determine whether the arbitration agreement is valid.[62] In reaching this decision, the Tenth Circuit appellate court distinguished other circuit decisions from *Spahr*,[63] therein providing a logical and useful analysis. *Spahr* reached a different outcome than other circuits have reached in similar cases because the Tenth Circuit interpreted Section 4 of the Act as distinguishing between contract claims that make a contract void, which should be heard by a court, and contract claims that make the contract voidable, which should be resolved in arbitration.[64] Therefore, if a contract claim would risk making the entire agreement void, including the arbitration agreement, a court should hear that claim; whereas a contract claim merely making the contract voidable that does not place the "making" of the arbitration agreement at issue should be resolved in arbitration.[65]

56. *Id.*
57. *Id.* at 1269.
58. *Id.* at 1267-68.
59. *Id.* at 1273.
60. *Id.* at 1272-73.
61. *Id.* at 1271.
62. *Id.* at 1269.
63. *Id.* at 1272-73.
64. *See id.*
65. *Id.*

c. Analysis of the Tenth Circuit's Holding in *Spahr v. Secco*

In *Spahr*, the Court began by applying Title 9 of the United States Code, Section 4, holding that "[i]t has long been a tenet of federal arbitration law that 'arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.'"[66] Thus, when a dispute arises that relates to the contract as a whole, and includes a broad arbitration agreement, there is not "the requisite clear and unmistakable evidence 'within the four corners of the . . . [a]greement that the parties intended to submit the question of whether an agreement to arbitrate exists to an arbitrator.'"[67]

Additionally, the Tenth Circuit held in *Spahr* that the *Prima Paint* holding did not apply to the facts in *Spahr* because "[u]nlike a claim of fraud in the inducement, which can be directed at individual provisions in a contract, a mental capacity challenge can logically be directed only at the entire contract" and thus goes to the making of the contract and should be decided in a court proceeding pursuant to Section 4.[68] The Tenth Circuit then applied Section 4, determining that a mental capacity claim does go to the making of the contract, and thus should be decided by a court rather than an arbitrator.[69]

The Tenth Circuit's decision in *Spahr*, that the mental capacity challenge goes to the "making" of the contract and thus should be decided by a court instead of an arbitrator, is likely to be criticized for departing from the position of the Supreme Court and other circuits in similar cases following *Prima Paint*.[70] The determination that a claim goes to the "making" of the contract and thus may be decided by a court pursuant to Section 4 will likely be used in rare circumstances because of the court's strong favor for arbitration, which is shown in court decisions that consistently uphold the FAA.[71] The Supreme Court is likely to hold that a case involving a mental capacity challenge is analogous to a claim of fraud in the inducement, in that both challenge the validity of the entire contract without questioning the "making" of the arbitration provision

66. *Id.* at 1269 (quoting AT&T Techs., Inc. v. Communications Workers of Am. 475 U.S. 643, 648 (1986)).

67. *Id.* at 1270 (quoting Riley Mfg. v. Anchor Glass Container Corp., 157 F.3d 775, 780 (10th Cir. 1998)).

68. *Id.* at 1273.

69. *Id.*

70. *See* Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395, 403-04 (1967); Primerica Life Ins. v. Brown, 304 F.3d 469, 471 (5th Cir. 2002); Jeske v. Brooks, 875 F.2d 71, 72 (4th Cir. 1989); Unionmutual Stock Life Ins. Co. of Am. v. Beneficial Life Ins., 774 F.2d 524, 528-29 (1st Cir. 1985).

71. *See Prima Paint*, 388 U.S. at 402; Doctor's Assocs. Inc. v. Casarotto, 517 U.S. 681, 683 (1996); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 23-26 (1991); Southland Corp. v. Keating, 465 U.S. 1, 17 (1984).

itself, and therefore both should be submitted to arbitration according to the agreement.[72]

To maintain consistency in their decisions, the Court may decide to reverse the decision in *Spahr*.[73] This may occur because after the Supreme Court made its decision in *Prima Paint*, other courts have consistently upheld the *Prima Paint* rationale by reversing inconsistent cases and setting a uniform standard of review for courts on every level.[74] There are compelling public policy reasons, however, for the Supreme Court to alter its decision in *Prima Paint* by incorporating the *Spahr* holding in deciding the arbitrability of claims that challenge contracts containing arbitration agreements. The primary public policy reasons include the fact that *Prima Paint* favors businesses over consumers, forces consumers into agreements they have not bargained for, and denies individuals their constitutional right to a jury trial.[75]

Although legislative intent stresses a national policy favoring arbitration, Congress has not displayed such favor towards businesses.[76] Regardless, the outcome of many arbitration disputes resulted in decisions unquestionably favoring businesses, leaving consumers in a position for which they never bargained.[77] *Prima Paint* and other decisions following its rationale do this very thing by favoring businesses and their adhesive agreements that unfairly bind consumers.[78] The challenge of enforcing arbitration agreements while not overstepping legislative intent is an obstacle courts will face in years to come. Arguably this challenge could best be overcome by adopting *Spahr* because *Spahr* reasonably and logically applies the Act without enforcing adhesive contracts that favor businesses.

Additionally, the constitutional right to a jury trial should not be overcome by an arbitration provision within a contract, when a party is challenging the validity of that entire contract, as this deprives the individual of the right to a jury trial and contravenes the legislative intent.[79] With these public policy reasons in mind, the Supreme Court would be reasonable and correct in adopting the *Spahr* decision as part of the standard in determining whether a claim challenging a contract containing an arbitration agreement should be resolved in a court proceeding rather than arbitration.

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72. *See Prima Paint*, 388 U.S. at 402; *Casarotto*, 517 U.S. at 683; *Gilmer*, 500 U.S. at 23-26; *Southland*, 465 U.S. at 17.

73. *See Primerica Life Ins.*, 304 F.3d at 472.

74. *Id.*

75. *See* Dauer, *supra* note 8, 94-96; Weston, *supra* note 3, at 600-01.

76. 9 U.S.C. §§ 1-16.

77. *See supra* note 13; *Casarotto*, 517 U.S. at 683.

78. Arguably, enforcing arbitration agreements against consumers favors businesses. *See Prima Paint*, 388 U.S. at 400-06.

79. *See Prima Paint*, 388 U.S. at 407-12 (Black, J., dissenting); MACNEIL, *supra* note 49, 83-121.

The Tenth Circuit's opinion in *Spahr*, which holds that a mental capacity claim goes to the "making" of the contract and should be heard by a court instead of an arbitrator,[80] appears to subject contracts with or without arbitration provisions to the same requirements. The trend of federal courts to enforce arbitration provisions in the manner Congress intended[81] at times gives contracts containing arbitration provisions more obstacles than those without arbitration provisions.[82] Consumers entering into such agreements are experiencing outcomes they might not logically expect, especially in cases where an arbitrator, rather than a judge, decides if an arbitration provision within a contract is enforceable.[83] The issue raises a serious problem in consumer contracts, because if a party is fraudulently induced into entering a contract, and the subsequent claims are then subjected to arbitration, that party arguably never entered into any valid agreement, let alone an agreement to arbitrate.[84] This contradiction produces unpredictable and illogical outcomes because contracts without an arbitration clause are held to a different standard than contracts containing them.[85]

Although the Tenth Circuit's opinion in *Spahr* departs from the *Prima Paint* rationale,[86] *Spahr* is nonetheless logical, fair, and provides a rational method of evaluating arbitration agreements. The main distinction between *Spahr* and *Prima Paint* is how and where these two courts draw the line in determining whether the "making" of the agreement to arbitrate shall be resolved by a court rather than arbitration.

The *Prima Paint* rationale focused on whether the challenge to the agreement goes to the "making" of the entire contract, versus the "making" of the arbitration provision, to determine whether the dispute should be resolved in a court rather than arbitration.[87] *Prima Paint* held that if a contract defense challenges the contract as a whole, it should be resolved

80. *Spahr*, 330 F.3d at 1272-73.

81. *See Casarotto*, 517 U.S. at 682-89; *Southland*, 465 U.S. at 5-7.

82. *See Casarotto*, 517 U.S. at 681-86; *Gilmer*, 500 U.S. at 24-26; *Southland*, 465 U.S. at 5-6; *Prima Paint*, 388 U.S. at 402; *Primerica Life Ins.*, 304 F.3d at 472; *Jeske*, 875 F.2d at 75; *Unionmutual Stock Life Ins.*, 774 F.2d at 529. *See generally* Edward A. Dauer, *Contracts of Adhesion in Light of the Bargain Hypothesis: An Introduction*, 5 AKRON L. REV. 1 (1972) (analyzing the pros and cons of arbitration provisions); Richard M. Alderman, *Pre-Dispute Mandatory Arbitration in Consumer Contracts: A Call for Reform*, 38 HOUS. L. REV. 1237 (2001) (discussing the shortcomings of arbitration provisions).

83. Rau, *supra* note 34, at 303-06; *see also* Alderman, *supra* note 82, at 1242.

84. *See* Pittman, *supra* note 17, at 790-93 (discussing adhesion contracts and the their negative effect on consumer contracts in stating, "there has been, and currently is, a legitimate concern over the use of adhesion contracts that force consumers to accept arbitration to resolve future disputes, including personal injury claims as well as contractual claims, arising out of their purchases of consumer goods.").

85. Rau, *supra* note 34, at 293.

86. *Compare Prima Paint*, 388 U.S. at 402-04, *with Spahr*, 330 F.3d at 1270-75.

87. *See Prima Paint*, 388 U.S. at 403-04.

in arbitration; whereas if the contract defense challenges the arbitration provision alone, a court should resolve the claim.[88]

Spahr, on the other hand, focused on what contract defenses challenge the "making" of the agreement to arbitrate, without limiting the defenses to those challenging the arbitration agreement itself.[89] *Spahr* determined contract defenses making the entire contract void should be resolved by a court instead of through arbitration.[90] Contract defenses making the contract voidable, however, do not specifically challenge the "making" of the arbitration agreement and should be resolved in arbitration.[91] The Tenth Circuit in *Spahr* did not contradict the *Prima Paint* rationale. Instead, *Spahr* chose a different method of analyzing the word "making," as set out in Section 4 of the Act.[92]

Overall, it appears that when a party is using a contract defense to invalidate a contract, the court's goal is to determine whether the "making of the agreement for arbitration . . . is not in issue" before compelling arbitration.[93] At this point the court will determine whether the contract defense should be reserved for courts to decide, which inevitably creates a potential conflict between Congress's intention to favor arbitration of claims, and an individual's right to not be obligated to arbitrate an agreement considered void pursuant to contract law. The courts then must decide which claims they will hear and which claims must proceed to arbitration, according to the agreement, in a realistic manner so that all claims alleging a contract defense will not end up in court. Giving every claim a court date would defeat the purpose of the FAA in trying to enforce arbitration provisions in order to reduce "costliness and delays of litigation."[94]

Both *Prima Paint* and *Spahr* attempt to find the appropriate place to draw the line in allowing certain cases to be heard by a court instead of requiring arbitration. Although *Prima Paint* and *Spahr* arrive at different outcomes in distinguishing between cases that must go to arbitration versus a court proceeding, both approaches are useful in trying to establish a workable rationale. Although *Prima Paint* and *Spahr* are not without their drawbacks in achieving logical and realistic outcomes,[95] a common

88. *Id.*
89. *See Spahr*, 330 F.3d at 1271-73.
90. *Id.* at 1273.
91. *See id.* at 1271-73.
92. *See id.*
93. 9 U.S.C. § 4.
94. Hai Jiang, *Do We Allow Contract Law to Administer Civil Rights Remedies?*, 2003 DETROIT COLL. L. MICH. ST. U. L. REV. 251, 273.
95. *See Prima Paint*, 388 U.S. at 395-407; *Spahr*, 330 F.3d at 1266-75. Arguably there are downfalls in the *Prima Paint* decision because although *Prima Paint* offers a reasonable analysis of when to send a case to arbitration instead of a court proceeding, subsequent outcomes achieved from *Prima Paint's* rationale at times do not seem logical and may not fully withstand the analytical scrutiny of other courts. Additionally in *Spahr*, there are downfalls as well because in separating out contract defenses that make a contract void, and then allowing those cases to be heard in court could

middle ground between the *Prima Paint* and *Spahr* opinions might allow arbitration provisions to receive the same "footing" as other contract provisions, yet loosen the adhesion many consumer arbitration provisions currently face.[96]

Other circuits have considered whether a contract defense invalidating an arbitration agreement should be resolved by arbitration rather than a court proceeding.[97] This paper now examines how these circuits resolve the arbitration dilemma.

B. Fifth Circuit

1. *Primerica Life Ins. v. Brown*[98]

a. Facts

Brown executed an agreement with CitiFinancial's affiliate, Primerica Life Insurance Co., which contained "an arbitration clause requiring arbitration of [Brown's] claims."[99] When a claim arose, Brown alleged he lacked the mental capacity to enter into the contract and therefore was not bound to the arbitration agreement because the contract was invalid.[100] The district court agreed, holding the arbitration provision unenforceable because Brown lacked the mental capacity to contract.[101]

b. Decision

In *Primerica*, the Fifth Circuit appellate court reversed the district court, holding that a mental capacity challenge to the entire contract must go to arbitration pursuant to the arbitration clause.[102] Relying on *Prima Paint*, the Fifth Circuit reasoned that pursuant to Section 4 of the FAA, federal courts may only consider "issues relating to the making and performance of the agreement to arbitrate."[103] The court explained that Brown's mental capacity claim challenged the entire contract without specifically challenging the arbitration clause, and thus issues relating to arbitration agreements were never disputed.[104] Without any issues relating to the arbitration agreement in controversy, the court determined it

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lead to the same problem that the FAA wanted to prevent; which includes reducing cases in the courts and not allowing the courts to give arbitration provisions less "footing" than other contract provisions.

96. *See, e.g., Prima Paint*, 388 U.S. at 423 (Black, J., dissenting) (recognizing the "purpose of the Act was to place arbitration agreements upon the same footing as other contracts" (internal quotations omitted)); *Casarotto*, 517 U.S. at 682 (recognizing and applying same principal); *Gilmer*, 500 U.S. at 24 (same); *Southland*, 465 U.S. at 15-16 (same).

97. *Spahr*, 330 F.3d at 1272.

98. 304 F.3d 469 (5th Cir. 2002).

99. *Primerica Life Ins.*, 304 F.3d at 470.

100. *Id.* at 471.

101. *Id.*

102. *Id.* at 472.

103. *Id.*

104. *Id.*

lacked authority to hear Brown's contract defense and submitted the claim to arbitration.[105]

C. Fourth Circuit

1. *Jeske v. Brooks*[106]

a. Facts

Jeske, an investor, sought investment advice from Brooks, an employee at an investment firm.[107] When Jeske entered into an investor relationship with Brooks, he signed an agreement that "contained an arbitration clause covering all disputes over matters relating to the agreement."[108] After suffering losses stemming from Brook's investment advice, Jeske filed claims against Brooks and Brooks' investment firm.[109] When Brooks asked the court to stay the proceedings and compel arbitration pursuant to the agreement, the district court compelled arbitration of the state law claims, but refused to require arbitration of the federal claims.[110]

b. Decision

In *Jeske*, the Fourth Circuit held that claims of unconscionability and lack of consideration challenge the entire contract's formation and as such should be decided by arbitration.[111] Relying on *Prima Paint*, the Fourth Circuit determined that when a claim challenges the validity of an entire contract, and the arbitration provision within the contract is not specifically challenged, the question regarding the contract's validity is within the scope of arbitration.[112] The court ignored the potential conflict that may exist when an entire contract is invalid as a matter of law, and thus the embedded arbitration clause is inapplicable, yet the claim must first go to arbitration to determine whether or not the contract is valid.[113]

105. *Id.*
106. 875 F.2d 71 (4th Cir. 1989).
107. *Jeske*, 875 F.2d at 72.
108. *Id.*
109. *Id.*
110. *Id.* at 72-73.
111. *Id.* at 75.
112. *Id.*
113. *See id.*

D. First Circuit

1. *Unionmutual Stock Life Ins. Co. of America v. Beneficial Life Ins.*[114]

a. Facts

Unionmutual and Beneficial, both insurance companies, entered into a "Portfolio Indemnification Reinsurance Agreement" which included an arbitration clause requiring any dispute arising from the indemnification agreement to be arbitrated in Portland, Maine.[115] After forming the agreement, Beneficial contacted Unionmutual to rescind the indemnification agreement, stating that the recent passage of the Deficit Reduction Tax Act "frustrated the purpose of the contract."[116] The district court granted Unionmutual's motion to compel arbitration of Beneficial's dispute.[117]

b. Decision

On appeal, the First Circuit appellate court affirmed, holding that claims of mutual mistake and frustration of purpose challenging the making of the entire contract should be decided by an arbitrator.[118] Relying on the severability doctrine discussed in *Prima Paint*, the court took the position that arbitration clauses "'are 'separable' from the contracts in which they are embedded, and that where no claim is made that fraud was directed at the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud.'"[119] The First Circuit court reasoned that Beneficial's attempt to invalidate the entire contract lacked an independent challenge to the validity of the arbitration agreement.[120] Without an independent challenge separating the arbitration agreement from the rest of the contract, the court determined arbitration was the appropriate forum to decide the validity of the contract.[121]

III. ANALYSIS

Several federal circuit courts of appeal reviewed cases involving contract defenses as applied to arbitration agreements.[122] Among the de-

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114. 774 F.2d 524 (1st Cir. 1985).
115. *Unionmutual Stock Life Ins.*, 774 F.2d at 525.
116. *Id.*
117. *Id.*
118. *Id.* at 529.
119. *Id.* at 528 (quoting Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395, 402 (1967)).
120. *Id.* at 529.
121. *Id.*
122. *See* Primerica Life Ins. v. Brown, 304 F.3d 469, 472 (5th Cir. 2002); Jeske v. Brooks, 875 F.2d 71, 75 (4th Cir. 1989); Unionmutual Stock Life Ins. Co. of Am. v. Beneficial Life Ins., 774 F.2d 524, 529 (1st Cir. 1985).

cisions discussed above, these courts all relied on the *Prima Paint* rationale in their decisions.[123] *Primerica*, *Jeske*, and *Unionmutual*, each held the contact claims in these cases were subject to arbitration, pursuant to the arbitration agreement in the contract, because the contract defenses challenged the overall contract and not the making of the arbitration agreement itself.[124] In each of these cases, the respective court applied the *Prima Paint* rationale in questioning whether the claim challenged the contract as a whole or just the arbitration agreement, to determine that each claim was subject to arbitration because each challenged the entire contract.[125]

The *Prima Paint* doctrine these circuits apply seems easily overcome if a party simply challenges the "making" of the arbitration agreement, in which case the party will receive a court hearing.[126] Otherwise, if the party challenges the contract as a whole, the party is subject to arbitration.[127] Therefore, to receive a court hearing and not be subject to arbitration, a party need only assert a claim challenging the arbitration agreement itself, instead of the entire contract.[128] This seems unreasonable and against the clear legislative intent behind the FAA.[129]

In *Spahr v. Secco*, the Tenth Circuit court interpreted Section 4 of the Act, holding that claims making a contract void, rather than voidable bring the "making" of the entire agreement, including the agreement to arbitrate, into issue and should be resolved in a court proceeding.[130] *Spahr* would likely reach a different outcome than the First, Fourth, and Fifth Circuits reached in similar cases because *Spahr* held contract defenses making the entire contract void also challenge the "making" of the arbitration agreement and should be resolved by a court.[131] *Spahr* draws the line between contract defenses challenging the "making" of an arbitration agreement, even if the defense challenges the entire contract as well, and contract defenses that do not.[132] According to *Spahr*, if a claim challenges the "making" of the arbitration agreement, a court should

123. *Primerica Life Ins.*, 304 F.3d at 472; *Jeske*, 875 F.2d at 75; *Unionmutual Stock Life Ins.*, 774 F.2d at 529.

124. *Primerica Life Ins.*, 304 F.3d at 472; *Jeske*, 875 F.2d at 75; *Unionmutual Stock Life Ins.*, 774 F.2d at 529.

125. *Primerica Life Ins.*, 304 F.3d at 472; *Jeske*, 875 F.2d at 75; *Unionmutual Stock Life Ins.*, 774 F.2d at 529.

126. *Primerica Life Ins.*, 304 F.3d at 472; *Jeske*, 875 F.2d at 75; *Unionmutual Stock Life Ins.*, 774 F.2d at 529.

127. Primerica Life Ins., 304 F.3d at 472; Jeske, 875 F.2d at 75; Unionmutual Stock Life Ins., 774 F.2d at 529.

128. *Primerica Life Ins.*, 304 F.3d at 472; *Jeske*, 875 F.2d at 75; *Unionmutual Stock Life Ins.*, 774 F.2d at 529.

129. Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395. 407-12 (1967) (Black, J., dissenting) (citing to specific legislative history for enacting the FAA); MACNEIL, *supra* note 49, at 83-121.

130. Spahr v. Secco, 330 F.3d 1266, 1267-68 (10th Cir. 2003).

131. *See Spahr*, 330 F.3d at 1267-68.

132. *See id.*

resolve that claim, regardless of the fact that the claim challenges the entire contract instead of just the arbitration agreement.[133] *Spahr's* reasoning not only takes into account whether the arbitration provision or the entire contract was being challenged, but whether the "making" of the arbitration agreement is at issue.[134]

The Tenth Circuit's decision in *Spahr* contributed to a split among the circuit courts[135] regarding different applications of Section 4 of the Act.[136] The Tenth Circuit explicitly disagreed with the Fifth Circuit in *Primerica Life Ins. v. Brown*,[137] holding that where a party claims a lack of mental capacity to enter into a contract, a court rather than an arbitrator should decide the claim.[138]

As *Spahr* reasoned, a person should not be subject to arbitration when he or she has not so agreed.[139] Therefore, when the "making" of a contract containing an arbitration agreement is at issue, it seems implicit that the person never agreed to arbitrate. The *Spahr* rationale takes into account the "tenet of federal arbitration law" in holding that regardless of whether the challenge goes to the "making" of the entire contract or the "making" of the arbitration agreement, a party should not be forced to submit a dispute to arbitration unless there was consent.[140] *Spahr* is different from *Prima Paint* because the latter distinguishes between whether the claim challenges the entire contract or the arbitration provision within the contract, and then resolves the claims that challenge the entire contract through arbitration.[141] Although the *Spahr* and *Prima Paint* rationales are not contradictory because they both apply similar interpretations of Section 4, their rationales do produce dissimilar results because of the different interpretations of the word "making."[142] As such, the Tenth Circuit's reasoning in *Spahr* is arguably the better approach in determining what cases should be heard by a court because the *Spahr* analysis truly questions whether the claim goes to the "making" of the agreement to arbitrate, rather than looking at whether the claim challenges the entire contract or the arbitration agreement alone.[143] *Spahr's* approach maintains a logical, fair, and rational method of evaluating arbitration agreements that gives them the same standing and enforceability as other contracts receive.

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133. *Id.*
134. *See id.*
135. *Id.*
136. *See* id.
137. 304 F.3d at 472 (holding a mental capacity defense that goes to the making of the entire contract must be arbitrated).
138. *Spahr*, 330 F.3d at 1272.
139. *Id.* at 1268.
140. *Id.* at 1269-75.
141. *See id.*; *Prima Paint*, 388 U.S. at 402-07.
142. *Prima Paint*, 388 U.S. at 402-07; *Spahr*, 330 F.3d at 1269-70.
143. *Spahr*, 330 F.3d at 1271-73.

Should the U.S. Supreme Court hear *Spahr*, its decision will affect not only the future of arbitration agreement enforceability, but also the fundamental procedural fairness for those entering into contracts containing them. Although *Spahr* reaches a different outcome from other circuit courts in cases with similar facts,[144] the Court will have the opportunity to create a fairer standard in arbitration agreement enforceability that is based on public policy concerns. The primary policy reasons for adopting *Spahr's* rationale is the promotion of fairness in the legal system by giving consumers the same treatment and protection businesses receive under the law, enforcing contracts consumers have freely bargained for, and affording individuals their constitutional right to a jury trial.[145] These are all important public policy reasons because the legal system is based in large measure on principles of equity, and currently the Court's stance on arbitration agreements strongly favors businesses, and unfairly binds consumers.[146] By adopting the Tenth Circuit's decision in *Spahr*, the Court better promote the goals of the Federal Arbitration Act .

CONCLUSION

With Congress passing the FAA in 1925 and the United States Supreme Court holding arbitration as a comparable means to litigation, deserving of the same "footing" as other contract provisions,[147] it is apparent the use of arbitration agreements will continue to grow consumer contracts. Arbitration is likely to play an important role in many future contract cases in the Tenth and other circuits, which is why it is so important to understand the opinion in *Spahr*.

When the Tenth Circuit in *Spahr* stated that a court should hear a case involving a mental capacity claim that challenges the validity of the entire contract,[148] it effectively established a new method of analyzing contract defenses that attack the validity of arbitration clauses. *Spahr* thus established a useful alternative to the *Prima Paint* rationale in determining whether a court shall hear a case or compel arbitration.[149] The rationale in *Spahr* may initially create confusion when compared to *Prima Paint* because *Spahr* seemingly reaches the opposite outcome from *Prima Paint* in cases with similar facts.[150] *Spahr*, however, does give an applicable interpretation of the word "making,"[151] as set forth in the Section 4 of the Act. This interpretation will likely aid courts in de-

144. *See supra* note 13.
145. *See* Dauer, *supra* note 8, 94-96; Weston, *supra* note 3, at 600-01.
146. *See* Dauer, *supra* note 8, 94-96; Weston, *supra* note 3, at 600-01.
147. *See* Doctor's Assocs. Inc. v. Casarotto, 517 U.S. 681, 687 (1996); Southland Corp. v. Keating, 465 U.S. 1, 7-18 (1984).
148. *See* Spahr v. Secco, 330 F.3d 1266, 1272 (10th Cir. 2003).
149. *Spahr*, 330 F.3d at 1272-75.
150. *See* Prima Paint Corp. v. Flood & Conklin Mfg., 388 U.S. 395, 402 (1967); *Spahr*, 330 F.3d at 1272.
151. *See Spahr*, 330 F.3d at 1272.

ciding cases while sustaining the intended purpose of the FAA. Importantly, the *Spahr* holding is critical in achieving outcomes that truly place arbitration provisions on the same "footing" as other contract provisions.[152]

*Michelle Canerday**

152. *See Casarotto*, 517 U.S. at 681-86.

* J.D. Candidate, 2005, University of Denver College of Law.

IN RE PARKER: THE TENTH CIRCUIT CHOOSES TWO PATHS OF ANALYSIS FOR THE BANKRUPTCY CODE

INTRODUCTION

On December 23, 2002, the Tenth Circuit Court of Appeals, in *In re Parker II*,[1] resolved the ambiguity of two important bankruptcy issues.[2] First, the Tenth Circuit adopted a mechanical analysis for determining whether to reopen a no asset, no bar date case, for use in deciding whether the claim is discharged according to section 523(a)(3)(A)[3] of the Bankruptcy Code.[4] The mechanical approach does not allow equitable considerations to intrude into a court's decision of whether to reopen a no asset case with no bar date.[5] Second, the Tenth Circuit adopted the conduct approach to determine the date a claim arises for purposes of the Bankruptcy Code's automatic stay provision.[6] Under the conduct approach, a claim arises on the date when the conduct causing the claim actually occurs, as opposed to when state law allows a claim to be commenced in court.[7] The Tenth Circuit's holdings regarding both the mechanical approach and conduct approach show the court's desire to protect the debtor and preserve the "fresh start" philosophy of the Bankruptcy Code.[8]

A no asset, no bar date case is a case in which it appears from the bankruptcy schedules that the debtor has no unencumbered assets that could result in a distribution to creditors through liquidation.[9] If a debtor has no assets to liquidate, the Rules of Bankruptcy Procedure likely will

1. Watson v. Parker (*In re* Parker II) 313 F.3d 1267 (10th Cir. 2002), *cert. denied*, 124 S. Ct. 429 (2003).

2. *See In re Parker II*, 313 F.3d at 1268.

3. 11 U.S.C. § 523(a)(3)(A) (2000). This survey deals exclusively with Bankruptcy issues under the Bankruptcy Code. Whenever a code section is referenced in the main text, that code section will fall within 11 U.S.C. §§ 101-1330 (2000).

4. *See In re Parker II*, 313 F.3d at 1268-69.

5. *Id.* at 1269 (quoting Watson v. Parker (*In re* Parker I), 264 B.R. 685, 695 (B.A.P. 10th Cir. 2001), *aff'd*, 313 F.3d 1267 (10th Cir. 2002)).

6. *Id.* at 1269-70. The automatic stay provision is located in section 362(a)(1) of the Bankruptcy Code. 11 U.S.C. § 362 (2000). The statute identifies those situations in which a stay of judicial action against a debtor is imposed. *See id.*

7. *In re Parker II*, 313 F.3d at 1269. *But see* Avellino & Bienes v. M. Frenville Co. (*In re* M. Frenville Co.), 744 F.2d 332, 337 (3d Cir. 1984) ("[W]hile federal law controls which claims are cognizable under the Code, the threshold question of when a right to payment arises, absent overriding federal law, 'is to be determined by reference to state law.'" (quoting Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 161 (1946))).

8. The "fresh start" philosophy of the Bankruptcy Code is the philosophy that "all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in bankruptcy." Grady v. A.H. Robins Co., 839 F.2d 198, 202 (4th Cir. 1988). Further, the automatic stay provision provides "a breathing spell to the debtor to restructure his affairs . . . ." *Grady*, 839 F.2d at 202.

9. *See* Dawson v. Unruh (*In re* Dawson), 209 B.R. 246, 248 (B.A.P. 10th Cir. 1997); *see also* FED. R. BANKR. P. 2002(e) (Notice of No Dividend).

not impose a bar date because, with no assets to distribute, it is irrelevant whether creditors file a claim.[10] When the debtor files for bankruptcy, in the spirit of the Bankruptcy Code's fresh start philosophy, the debtor is seeking the discharge of all her outstanding debts.[11] In the debtor's petition for bankruptcy, she is required to name all of her outstanding debts as well as the creditors to whom those debts are owed.[12]

The mechanical approach applies in situations where, after the debtor has received her discharge from the bankruptcy court, she remembers that she omitted a creditor from her schedule of creditors.[13] The debtor wonders whether she must petition to reopen her Chapter 7 no asset, no bar date case to receive a discharge from the omitted debt.[14] Additionally, the debtor worries whether section 523(a)(3)(A), which excepts a claim from discharge "if it was neither listed nor scheduled and the creditor did not have notice or actual knowledge of the case so that the creditor could timely file a claim," will apply to the omitted debt.[15] The debtor also worries whether the court will inquire into her intent behind the omission of the creditor.[16] Under the mechanical approach that the Tenth Circuit adopted in *In re Parker II*, the debtor will be able to remedy her forgetfulness and receive a discharge without reopening her bankruptcy case.[17] Consequently, the debtor will no longer need to worry about the court inquiring into the circumstances around her forgetfulness, nor need she worry about whether section 523(a)(3)(A) will bar the dischargeability of her debt. [18] This result, however, would be different if the debtor's court was on the other side of the circuit split which adopts the equitable approach.[19]

The Federal circuits are split regarding whether a debtor must reopen a bankruptcy case to receive a discharge from an omitted claim, and whether the bankruptcy court should look into the debtor's intent behind failing to originally file the claim before allowing it to be reopened.[20] Section 350(b) of the Bankruptcy Code allows a bankruptcy case to be

10. *See* FED. R. BANKR. P. 3002(a). A bar date pursuant to Rule 3002(c) of the Federal Rules of Bankruptcy Procedure is a date that serves as a deadline for creditors to file a proof of claim in which to receive a dividend or participate in the debtor's bankruptcy proceedings. *See* FED. R. BANKR. P. 3002(c); *see also* FED. R. BANKR. P. 2002(e). Rules 3002(a) and 2002(e) are used in the context of this Survey to illuminate the effect of a debtor's absolute lack of assets on the procedures of a bankruptcy case.

11. *See In re Parker I*, 264 B.R. at 694.

12. 11 U.S.C. § 521(1) (2000).

13. *See* Alexander L. Edgar, *The Law of Reopening – Revisited*, AM. BANKR. INST. J., Feb. 2001, at 8, 8.

14. *See In re Parker I*, 264 B.R. at 693.

15. *Id.* at 695.

16. *See id.* at 693-94. Courts that apply the equitable, rather than conduct, approach reason that "the intent of the Debtor at the time of the omission is relevant to the inquiry." *Id.* at 694 (discussing *e.g.*, Stark v. St. Mary's Hosp. (*In re* Stark), 717 F.2d 322 (7th Cir. 1983)).

17. *In re Parker II*, 313 F.3d at 1269 (quoting *In re Parker I*, 264 B.R. at 695).

18. *See id.*

19. *E.g.*, *In re M. Frenville Co.*, 744 F.3d 332.

20. *In re Parker I*, 264 B.R. at 693.

reopened in the same court in which it was closed.[21] The federal courts that adopt the equitable approach hold that the debtor's intent behind failing to list the omitted claim is relevant when deciding whether to reopen a bankruptcy case.[22] These courts view the reopening of the bankruptcy case as a necessary step before discharging an omitted debt under section 523(a)(3)(A).[23] The circuits that use the mechanical approach hold that the reopening of a bankruptcy case has no effect on the dischargeability of a debt.[24] The mechanical approach is based on the notion that the discharge of a debt is done by operation of law under section 727 of the Code, and that section 523(a)(3)(A) does not apply to a no asset, no bar date case.[25] The debtor's intent behind not filing the claim originally is irrelevant under the mechanical approach.[26] In *In re Parker II*, the Tenth Circuit adopted the mechanical approach.[27]

In re Parker II also decided another important bankruptcy issue regarding the Bankruptcy Code's automatic stay provision.[28] Section 362(a)(1) sets forth "an automatic stay of, among other things, judicial action against the debtor 'to recover a claim against the debtor that arose *before* the commencement of the case under this title.'"[29] For purposes of the automatic stay provision, federal courts have taken two approaches to the method of determining whether a claim arose before or after the bankruptcy proceedings were filed.[30] The first approach used by the courts is the conduct theory, in which the date the claim arises is determined by the date in which the conduct "giving rise to the claim" occurs.[31] The second approach, the accrual theory, "determines the date of a claim pursuant to the state law under which liability for the claim arose."[32] In *In re Parker II*, the Tenth Circuit adopted the conduct theory.[33]

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21. 11 U.S.C. § 350(b) (2000).
22. *See In re Parker I*, 264 B.R. at 693-94.
23. *Id.*; *see also In re Stark*, 717 F.2d at 324.
24. *In re Parker I*, 264 B.R. at 694.
25. *See id.*; *see also* Zirnhelt v. Madaj (*In re* Madaj), 149 F.3d 467, 472 (6th Cir. 1998).
26. *In re Parker I*, 264 B.R. at 694.
27. *In re Parker II*, 313 F.3d at 1268.
28. *See id.* at 1269 ("The second issue concerns determination of the date on which a claim arose for purposes of classifying it as a pre-or post-petition claim.").
29. *In re Parker II*, 313 F.3d at 1270 (citing *Grady*, 839 F.2d at 202 (quoting 11 U.S.C. § 362(a)(1) (2000)) (emphasis added). Claims arising pre-petition are claims made by creditors, against the debtor, *before* the debtor files for bankruptcy. *See generally* Robert J. Scott, *When a Claim Arises Under the Bankruptcy Code*, 24 HOFSTRA L. REV. 253 (1995). Claims that arise post-petition are those where the creditor seeks collection of a debt owed *after* the debtor has filed for bankruptcy. *See generally id.*
30. *See In re Parker II*, 313 F.3d at 1269.
31. *Id.*
32. *Id.*
33. *Id.* ("We now adopt the conduct theory as the one more in tune with the plain language and the policy underlying the Bankruptcy Code.").

I. BACKGROUND OF CIRCUIT SPLITS

In 1904, the Supreme Court decided *Birkett v. Columbia Bank*.[34] In *Birkett*, the Supreme Court strictly interpreted bankruptcy law to protect the creditor from the debtor "experimenting" with the law and to allow the creditor the "natural" rights of the law.[35] Interpreting the bankruptcy law at the time, the Supreme Court discussed the importance of a debtor scheduling a debt and listing creditors in a bankruptcy proceeding.[36] Referring to Section 17 of the Bankrupt Law of 1898, a predecessor to section 523(a)(3)(A) of the current code, the Supreme Court held that actual knowledge of a bankruptcy proceeding was knowledge that allowed the creditor to timely avail himself of the benefits of law.[37] The Court rejected the notion that actual knowledge included any knowledge of the bankruptcy proceedings regardless of the timing.[38] The Court held that bankruptcy law would be defective if it did not allow the creditor remedies against the debtor.[39] Thus, the Court in *Birkett* held that debts scheduled after the original petition, "omitted debts," would not be discharged in bankruptcy because of the prejudice against the creditor.[40]

In 1978, Congress adopted the Bankruptcy Reform Act.[41] The Bankruptcy Reform Act created the present Bankruptcy Code.[42] Congress's enactment of the Code was intended to overrule *Birkett*.[43] The Code was enacted as "a significant departure from present law. . . . [T]he bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy

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34. 195 U.S. 345 (1904).

35. *Birkett*, 195 U.S. at 350-51; *see also* Bruce White & Maria H. Belfield, *Is the Debtor's Failure to List Claims Fatal?*, AM. BANKR. INST. J., May 1998, at 40, 40. *Birkett* was interpreting the Bankrupt Law of 1898, the existing bankruptcy law at the time. *See Birkett*, 195 U.S. at 349.

36. *Birkett*, 195 U.S. at 349.

37. *Id.* at 350 (discussing § 17 of the Bankrupt Law of 1898, *repealed by* the Bankruptcy Reform Act of 1978, Pub. L. No. 95-958, 92 Stat. 2549 (codified at 11 U.S.C. §§ 101-1330)). Section 17 of the Bankrupt Law of 1898 provided:

> A discharge in bankruptcy shall release a bankrupt of all of his provable debts, except such as . . . have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy . . . .

Id. at 349 (quoting § 17 of the Bankrupt Law of 1898).

38. *See id.* at 350.

39. *Id.*

40. *See id.* at 350-51; *see also* White & Belfield, *supra* note 35, at 40 (citing *Birkett*, 195 U.S. at 350).

41. Bankruptcy Reform Act of 1978, Pub. L. No. 95-958, 92 Stat. 2549 (codified at 11 U.S.C. §§ 101-1330).

42. *See* White & Belfield, *supra* note 35, at 40-41.

43. Beezley v. Cal. Land Title Co. (*In re* Beezley), 994 F.2d 1433, 1439 (9th Cir. 1993) (O'Scannlain, J., concurring) ("The legislative history of section 523(a)(3) declares unambiguously that *Birkett* was intended to be overruled.").

case."[44] Congress's 1978 enactment of the Bankruptcy Code was intended to allow the debtor a fresh start.[45]

Two parts of the 1978 Code are relevant to *In re Parker II*: section 523 and section 362.[46] Section 523 states, in pertinent part:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt--
>
> (3) neither listed nor scheduled . . . in time to permit--
>
> (A) if such debt is not of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim, unless such creditor had notice or actual knowledge of the case in time for such timely filing; . . . .[47]

In re Parker II also addresses section 362 of the Code, known as the automatic stay provision.[48] The automatic stay provision provides:

> (a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities, of--
>
> (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title; . . . .[49]

A. The History of Circuit Splits Regarding Section 523

The circuit courts are split regarding how section 523 of the Code affects the dischargeability of an omitted claim in a no asset, no bar date bankruptcy, and the analysis the court should use in determining whether to reopen a case.[50] The Third, Sixth, and Ninth Circuits have held that a debtor's intent "is irrelevant to the bankruptcy court's decision to reopen" a case.[51] Since a debtor is required to list all creditors and debts

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44. Watson v. Parker (*In re* Parker I), 264 B.R. 685, 697 (B.A.P. 10th Cir. 2001), *aff'd*, Watson v. Parker (*In re* Parker II), 313 F.3d 1267 (10th Cir. 2002) (quoting S. REP. NO. 95-989, at 21-22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787).

45. *In re Parker I*, 264 B.R. at 697-98.

46. *See In re Parker II*, 313 F.3d 1267, 1269-70 (citing 11 U.S.C. §§ 362(a)(1), 523(a)(3)(A) (2000)).

47. 11 U.S.C. § 523(a)(3)(A).

48. *In re Parker II*, 313 F.3d at 1270.

49. 11 U.S.C. § 362(a)(1).

50. *See In re Parker II*, 313 F.3d at 1268.

51. *Id.* at 1268-69 (citing Zirnhelt v. Madaj (*In re* Madaj), 149 F.3d 467, 471 (6th Cir. 1998); Judd v. Wolfe (*In re* Judd), 78 F.3d 110, 115-16 (3d Cir. 1996); *In re Beezley*, 994 F.2d at 1439).

owed to each creditor upon the filing of a bankruptcy petition,[52] these courts do not look to the debtor's intent behind omitting a creditor or debt from the original bankruptcy petition.[53] This approach is known as the mechanical approach.[54] The Fifth, Seventh, and Eleventh Circuits have held that a court must look to the debtor's intent for omitting the claim to determine whether or not to reopen a bankruptcy case.[55] These circuits adopt the equitable approach.[56]

The Third Circuit adopted the mechanical approach in *In re Judd*.[57] There, the Third Circuit held that the scheduling of a debt, or lack of scheduling, does not affect the debt's dischargeability.[58] The Third Circuit holds that it is therefore unnecessary to reopen a bankruptcy claim to receive a discharge.[59] The Sixth Circuit in *In re Madaj* adopted the mechanical approach, calling the reopening of a no asset bankruptcy case to schedule an omitted debt a "useless gesture."[60] Finally, the Ninth Circuit also adopted the mechanical analysis in *In re Beezley*.[61]

The Fifth, Seventh, and Eleventh Circuits have held that the debtor's intent is relevant when deciding whether or not to reopen a bankruptcy case.[62] The Seventh Circuit was the first to adopt this approach in *In re Stark*. There, the Seventh Circuit held that "a debtor may reopen the estate to add an omitted creditor where there is no evidence of fraud or intentional design."[63] With this holding, the Seventh Circuit opened the door to the inference that the reopening of a debtor's chapter 7 no asset case is relevant to the dischargeability of a claim.[64]

In *In re Faden*, the Fifth Circuit held that the debtor's intent for failing to schedule a creditor is relevant to the dischargeability of a debt under section 523(a)(3)(A).[65] The Fifth Circuit went beyond *In re Stark*'s analysis and adopted three factors relevant to evaluate

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52. 11 U.S.C. § 521(1).

53. *In re Parker I*, 264 B.R. at 694; *see also infra* notes 132-62 and accompanying text.

54. *See In re Parker I*, 264 B.R. at 694.

55. *Id.* at 693-94 (citing Faden v. Ins. Co. of N. Am. (*In re* Faden), 96 F.3d 792, 797 (5th Cir. 1996); Stark v. St. Mary's Hosp. (*In re* Stark), 717 F.2d 322 (7th Cir. 1983); Samuel v. Baitcher (*In re* Baitcher), 781 F.2d 1529, 1534 (11th Cir. 1986)).

56. *See id.* at 693 (citing *In re Faden*, 96 F.3d at 797; *In re Stark*, 717 F.2d 322; *In re Baitcher*, 781 F.2d at 1534).

57. *See In re Judd*, 78 F.3d at 115.

58. *Id.* at 111.

59. *Id.*

60. *In re Madaj*, 149 F.3d at 468.

61. *In re Beezley*, 994 F.2d at 1434.

62. *See In re Parker I*, 264 B.R. at 693-94 (citing *In re Faden*, 96 F.3d at 797; *In re Stark*, 717 F.2d 322; *In re Baitcher*, 781 F.2d at 1534).

63. *In re Stark*, 717 F.2d at 324.

64. *See* Edgar, *supra* note 13, at 8.

65. *See In re Faden*, 96 F.3d at 796 (citing Robinson v. Mann, 339 F.2d 547, 550 (5th Cir. 1964) (reasoning that a court should not discharge a debt under section 523(a) if the debtor's failure was due to intentional design, fraud, or improper motive)).

> whether a debtor's failure to list a creditor properly will prevent discharge of the unscheduled debt: (1) the reasons the debtor failed to list the creditor; (2) the amount of disruption that would likely occur; and (3) the prejudice suffered by the listed creditors and the unlisted creditor in question.[66]

The Fifth Circuit also places the burden on the debtor to show that the failure to schedule the creditor was not motivated by fraud or intentional design.[67] Thus, the Fifth Circuit adopted an equitable approach to determining whether or not an omitted debt should be discharged pursuant to section 523(a)(3)(A).[68]

The Eleventh Circuit held the debtor's intent to be relevant for purposes of discharge under section 523(a)(3)(A) of the Code in *In re Baitcher*.[69] Following the Seventh Circuit, the Eleventh Circuit held that fraud or intentional design must be absent for a debtor to receive a discharge for an unscheduled debt under section 523(a)(3)(A) of the Code.[70]

The Tenth Circuit was undecided on the proper approach to reopening a no asset, no bar date case until *In re Parker II*.[71] Prior to *In re Parker II*, the Tenth Circuit, in *In re Dawson*,[72] held that equitable considerations could not override section 523(a)(3)(A) in a no asset case, but did not address whether equitable considerations would apply in a no asset case with no set bar date.[73] Additionally, the Tenth Circuit did not address whether the court should consider the debtor's intent for failing to schedule a claim when determining whether to reopen a no asset, no bar date case.[74] In *In re Dawson*, the Tenth Circuit referred to its adherence to a "stricter construction" of the Code and desire to follow the "clear language of the statute."[75] The Tenth Circuit, however, remained undecided on both of these issues regarding a no asset, no bar date case until *In re Parker II*.[76]

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66. *Id.* The Fifth Circuit finds the three relevant factors from an earlier case, *Robinson*. *Id.* (citing *Robinson*, 339 F.2d at 550). *Robinson* was decided prior to the enactment of the modern Bankruptcy Code in 1978. *See id.* Thus, in *In re Faden*, the Fifth Circuit is adopting the *Robinson* principles for analysis under the new Code. *See id.*

67. *Id.*

68. *Id.* at 797 ("Thus, even absent prejudice, equitable action should not be taken in cases where the debtor's failure to properly schedule a creditor is a result of more than 'mere negligence or inadvertence.'").

69. *See In re Baitcher*, 781 F.2d at 1534.

70. *See id.*

71. *See In re Parker II*, 313 F.3d at 1268.

72. Dawson v. Unruh (*In re* Dawson), 209 B.R. 246 (B.A.P. 10th Cir. 1997).

73. *In re Dawson*, 209 B.R. at 250.

74. *In re Parker I*, 264 B.R. at 694 n.8 (discussing *In re Dawson* decision).

75. *In re Dawson*, 209 B.R. at 250. The Tenth Circuit refers to two lines of reasoning, the liberal approach and the stricter approach, which emerged from the predecessor of section 523(a)(3) under the repealed Bankruptcy Act. *Id.*

76. *See In re Parker II*, 313 F.3d at 1269.

B. The History of Circuit Splits Regarding Section 362(a)(1)

The circuit courts are split regarding whether to use the conduct approach or accrual approach for determining the date a claim arises for purposes of the Code's automatic stay provision.[77] The date a claim arises serves to classify a claim as pre-petition or post-petition with regard to the automatic stay provision under section 362(a)(1).[78] A claim is a right to payment, made by a creditor, that the debtor desires to be discharged by filing for bankruptcy.[79] If a claim is classified as a post-petition claim, the debtor will not receive protection under the bankruptcy laws and the claim will not be discharged.[80] Thus, a debtor can only receive relief from the bankruptcy proceedings, the discharge of a claim against him, if the claim is classified as pre-petition.[81] A creditor may want a claim to be classified as pre-petition or post-petition depending on the type of bankruptcy proceeding.[82] Most likely, however, a creditor would prefer a claim to be classified as post-petition, because the claim will not be discharged in bankruptcy and will be a remaining obligation when the bankruptcy is complete.[83]

The conduct approach to determining when a claim arose for purposes of classifying it as a pre-petition or post-petition claim is the predominate approach among the circuit courts.[84] The conduct approach classifies a claim as a pre-petition one if "the acts giving rise to the alleged liability were performed" prior to the commencement of bankruptcy proceedings.[85] The Fourth Circuit adopted the conduct approach in *Grady v. A.H. Robbins Co.*[86] The Fourth Circuit approach is an example of the basic conduct approach, which does not refer to state law to determine when a claim arises.[87] *Grady* held that a claim is classified as pre-petition if the conduct causing the claim occurs prior to the bankruptcy petition.[88] Section V, Part A of this paper, *infra*, will discuss *Grady*'s holdings in detail.

Only the Third Circuit adopts the accrual approach.[89] The accrual approach looks at the law of the state in which the claim arose to deter-

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77. *Id.*

78. *See* 11 U.S.C. § 362(a)(1).

79. *See* BLACK'S LAW DICTIONARY 240-41 (7th ed. 1999) ("A right to payment or to an equitable remedy for breach of performance if the breach gives rise to a right to payment.").

80. *See Grady*, 839 F.2d at 200-01.

81. Dale Ellen Azaria, *When Is a Claim a Claim? A Bankruptcy Code Riddle*, 62 TENN. L. REV. 205, 207-08 (1995).

82. *See id.* at 208-09 (explaining that a putative creditor may want to participate depending on the likelihood they will prevail in other forums besides the bankruptcy arena).

83. *See id.*

84. *See In re Parker II*, 313 F.3d at 1269.

85. Scott, *supra* note 29, at 263 (quoting *In re* Johns-Manville Corp., 57 B.R. 680, 690 (Bankr. S.D.N.Y. 1986)).

86. *Grady*, 839 F.2d at 201.

87. *Id.*

88. *Id.* at 203.

89. *In re Parker II*, 313 F.3d at 1269 (quoting *Grady*, 839 F.2d at 201).

mine the date of the claim.[90] The Third Circuit adopted this approach in *In re M. Frenville Co.*[91] There, the Third Circuit held that the automatic stay provision is "not all encompassing" and requires a claim, in order to receive the protection from automatic stay, to have commenced or have been able to commence.[92] In determining whether a claim could have been commenced before the filing of bankruptcy, the Third Circuit focuses on when a claim's right to payment arose, and inquiry which turns on state law.[93]

While the majority of the circuits have adopted the conduct approach, there is a split between two versions of the conduct approach.[94] Courts are split between adopting the basic conduct approach, illustrated in *Grady*, or a more narrow conduct theory.[95] *In re Piper Aircraft Corp.*[96] articulates the narrow conduct approach. This approach, in essence, narrows the definition of a prepetition claim under the conduct theory.[97] Under the narrow conduct approach, "a claim arises at the time of the conduct upon which the debtor's liability is based only if the claimant had a specific relationship with the debtor at the time the conduct occurred."[98] The Tenth Circuit has not decided whether to adopt the narrow version of the conduct approach or to continue with the basic theory.[99] Thus, for purposes of this paper, the conduct approach referred to herein will be the basic conduct approach as articulated by *Grady*.

Prior to *In re Parker II*, the Tenth Circuit was undecided as to which theory to adopt in determining whether to classify a particular claim as pre-petition or post-petition for the purposes of the automatic stay provision.[100] In *In re Grynberg*,[101] the Tenth Circuit avoided taking sides on the circuit split.[102] The court stated that "[w]hile it is superficially tempting to analyze this case based on whether the claim can be categorized as prepetition . . . our evaluation persuades us that a different analysis is required."[103] Similarly, in *In re Franklin Savings Ass'n*,[104] the Tenth Circuit again avoided a definitive decision on which standard to

90. *Id.*
91. Avellino & Bienes v. M. Frenville Co. (*In re* M. Frenville Co.), 744 F.2d 332, 334-35 (3d Cir. 1984).
92. *In re M. Frenville Co.*, 744 F.2d at 334-35.
93. *Id.* at 337.
94. *In re Parker II*, 313 F.3d at 1270 n.1.
95. *In re Parker I*, 264 B.R. at 697-98.
96. 162 B.R. 619 (Bankr. S.D. Fla. 1994), *aff'd*, 168 B.R. 434 (S.D. Fla. 1994).
97. *In re Parker I*, 264 B.R. at 697 n.12.
98. *Id.* at 697.
99. *In re Parker II*, 313 F.3d at 1270 n.1.
100. *Id.* at 1268-69.
101. Grynberg v. Danzig Claimants (*In re* Grynberg), 966 F.2d 570 (10th Cir. 1992).
102. *See In re Grynberg*, 966 F.2d at 572.
103. *Id.*
104. Franklin Savs. Ass'n v. Office of Thrift Supervision (*In re* Franklin Savs. Ass'n), 31 F.3d 1020 (10th Cir. 1994).

adopt.[105] The *In re Franklin Savings Ass'n* court held that it was able to classify the Director's costs as a pre-petition claim under both the accrual and conduct theories.[106] Thus, the court decided it would be superfluous to make the decision of which theory to adopt at that time.[107] In *In re Parker II*, the Tenth Circuit finally adopted the conduct approach.[108]

II. TENTH CIRCUIT: DECIDING ON TWO PATHS OF ANALYSIS FOR THE BANKRUPTCY CODE

A. In re Parker II[109]

1. Facts

In re Parker II is an appeal from the United States bankruptcy appellate panel.[110] Parker, the debtor, was at one time the attorney for Watson, the creditor.[111] In December of 1995, Parker filed a complaint for Watson in the United States District Court for the District of Kansas against Watson's former employer.[112] The District Court ordered Parker to file a motion by May 24, 1996, stating why the case should not be dismissed for failure to serve the defendant within the required 120 days.[113] Parker neglected to file a timely response and the case was dismissed.[114] On November 26, 1996, Parker filed for Chapter 7 bankruptcy and failed to list Watson as a creditor.[115] During the pendency of his bankruptcy, Parker admitted to committing malpractice in Watson's case and filed a motion on January 23, 1997, to reinstate her case.[116] Subsequently, Watson terminated Parker's employment as her attorney.[117] Parker received a discharge from bankruptcy on May 14, 1998.[118] Watson filed a malpractice case against Parker in July 1998.[119] Parker asserted the affirmative defense that Watson's claim had been discharged by his bankruptcy.[120] On May 6, 2000, Parker filed a motion to reopen his Chapter 7 case in order to include Watson's claim, and additionally to receive a discharge from the debt.[121] Watson opposed the reopening of

105. *In re Franklin Savs. Ass'n*, 31 F.3d at 1022.
106. *Id.*
107. *See id.*
108. *In re Parker II*, 313 F.3d at 1269.
109. Watson v. Parker (*In re* Parker II), 313 F.3d 1267 (10th Cir. 2002), *cert. denied*, 124 U.S. 429 (2003).
110. *In re Parker II*, 313 F.3d at 1268.
111. Watson v. Parker (*In re* Parker I), 264 B.R. 685, 689-90 (B.A.P. 10th Cir. 2001), *aff'd*, 313 F.3d 1267 (10th Cir. 2002).
112. *In re Parker I*, 264 B.R. at 690.
113. *Id.*
114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.* at 691.
120. *Id.*
121. *Id.*

Parker's Chapter 7 case because she believed the reopening would affect the dischargeability of her claim and equitable principals precluded the court from reopening the bankruptcy.[122] Watson believed that the reopening of Parker's bankruptcy should be prevented by the court because of laches, equitable estoppel, or because she would suffer unfair prejudice from the possible reopening.[123]

On October 5, 2000, the bankruptcy court permitted Parker's case to be reopened and Watson's debt discharged.[124] First, the bankruptcy court found the reopening of Parker's bankruptcy case would only serve to determine the dischargeability of Watson's claim.[125] Next, the bankruptcy court looked at two issues that would affect the dischargeability of Watson's claim: section 523(a)(3)(A) or under section 523(a)(3)(B) that the debt was nondischargeable under sections 523(a)(2), (4) or (6).[126] Finding that neither of the section 523 nondischargeability requirements were met, the bankruptcy court granted Parker a discharge of Watson's claim.[127] The bankruptcy appellate panel affirmed the decision of the court and Watson appealed to the Tenth Circuit Court of Appeals.[128]

On appeal, Watson contended that the bankruptcy panel's decision to reopen and discharge her claim should have been precluded on two issues.[129] First, Watson argued that various equitable principals should have precluded Parker from reopening her case.[130] Secondly, Watson argued that the claim is nondischargeable for two reasons: it arose post-petition and because the claim otherwise met the nondischargeability requirements of the Code.[131]

2. Decision

The Tenth Circuit Court of Appeals affirmed the holding of the Bankruptcy Appellate Panel in *Parker I*.[132] The Tenth Circuit decided two issues of first impression.[133] First, the Tenth Circuit adopted the mechanical approach to determine whether a debtor's claim should be reopened in a no asset Chapter 7 case with no bar date.[134] Second, the Tenth Circuit adopted the conduct approach when determining if a claim

122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*
128. *Id.*.
129. *In re Parker II*, 313 F.3d at 1268.
130. *Id.*
131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.* at 1268-69.

arose pre-petition or post-petition for purposes of the Bankruptcy Code's automatic stay provision.[135]

Under the mechanical approach, a debtor does not need to reopen a no asset, no bar date case to receive a discharge for an omitted debt because reopening has no effect on the dischargeability of the omitted debt.[136] By adopting the mechanical approach, the Tenth Circuit joined the Third, Sixth, and Ninth Circuits.[137] When adopting the mechanical approach, the Tenth Circuit referred to the bankruptcy appellate panel's explanation that the mechanical approach is "'better reasoned and more faithful to the language of the Bankruptcy Code.'"[138]

The bankruptcy appellate panel reasoned that under section 727(b) of the Code, "the Debtor receives a discharge from all debts that arose before the date of the order for relief . . . unless an exception in 523(a) applies."[139] Under section 523(a)(3)(A) "a claim will not be discharged if it was neither listed nor scheduled and the creditor did not have notice or actual knowledge of the case so that the creditor could timely file a claim."[140] Since Parker's case was a no asset case with no bar date, "Watson will have an opportunity to file a claim if any assets are discovered."[141] A no asset case is a bankruptcy case "indicating that no assets were available for liquidation and distribution to creditors."[142] Because Watson would have the opportunity to file a claim if any assets were discovered, the bankruptcy appellate panel found, and Tenth Circuit affirmed that Watson would suffer no prejudice.[143] Therefore, because "equitable considerations do not impact the dischargeability of a debt under § 523(a)(3)(A)" it is unnecessary to reopen a debtor's Chapter 7 case for determination of equitable principals such as the debtor's intent for failing to list the omitted creditor.[144]

Next, the Tenth Circuit adopted the conduct theory for determining when a claim arises for purposes of the automatic stay provision.[145] The

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135. *Id.* at 1269.

136. *In re Parker I*, 264 B.R. at 694 ("[T]he majority of courts apply the mechanical approach . . . that pursuant to the plain language of the Bankruptcy Code the debt is discharged by operation of law and that to reopen a bankruptcy case to schedule a previously unlisted debt in a no asset, no bar date case has no effect on the dischargeability of the debt."). The logic of this reasoning is apparent: a no asset case is one where the debtor has no money, liquidated or otherwise, to distribute to the creditors. Dawson v. Unruh (*In re* Dawson), 209 B.R. 246, 248 (B.A.P. 10th Cir. 1997). If a creditor is omitted from the schedule it has no impact: there are no assets to distribute, and the creditor has no relief even if he were on the schedule. There are currently no assets, nor were there assets during the bankruptcy proceeding, so the unscheduled debt is merely discharged as though it were scheduled.

137. *In re Parker II*, 313 F.3d at 1269.

138. *Id.* at 1268 (quoting *In re Parker I*, 264 B.R. at 694).

139. *In re Parker I*, 264 B.R. at 694.

140. *Id.* at 694-95.

141. *Id.* at 695.

142. *In re Dawson*, 209 B.R. at 248.

143. *In re Parker I*, 264 B.R. at 695.

144. *Id.*

145. *In re Parker II*, 313 F.3d at 1269-70.

Tenth Circuit adopted the conduct theory, finding that it was "more in tune with the plain language and the policy underlying the Bankruptcy Code."[146]

First, the Tenth Circuit affirmed the appellate panel's consideration of the language of the Code.[147] The Court looked to the Code's definition of "claim," which is defined as a "'right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured . . . .'"[148] The appellate panel reasoned that the pivotal word of the Code's definition of "claim" to be "contingent."[149] Referencing Black's Law Dictionary, the court found the definition of "contingent claim" to be "'one which has not accrued and which is dependant on some future event that may never happen.'"[150] The Court determined that the Code "expressly delineates the boundaries of the term claim."[151] Since the Code gives the boundaries of the word "claim" and the definition includes "contingent claims," a court must encompass this definition when determining whether a claim existed before the filing of the bankruptcy, pre-petition.[152] Thus, the appellate panel found that, when determining if a claim has arisen, the central issue for the court is whether the claim existed pre-petition, not whether the claim was valid under state law.[153]

Second, the court looked to the policy behind the Code when deciding to adopt the conduct approach.[154] Finding that legislative history pointed to an expansive definition of the word "claim,"[155] the court determined that the philosophy of the Code was to allow the debtor to achieve a "fresh start."[156] Included in this fresh start philosophy, the court found that Congress intended that "all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case."[157] Thus, the Tenth Circuit held that the Bankruptcy Code allows the "broadest possible relief" and the conduct theory best captures this purpose.[158]

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146. *Id.* at 1269.
147. *Id.* at 1268 (quoting *In re Parker I*, 264 B.R. at 694-95).
148. *In re Parker I*, 264 B.R. at 697 (quoting 11 U.S.C. § 101(5)(A)).
149. *Id.*
150. *Id.* (quoting BLACK'S LAW DICTIONARY 290 (5th ed. 1979)).
151. *Id.*
152. *Id.*
153. *Id.*
154. *Id.*
155. *Id.*
156. *Id.* at 698.
157. *Id.* at 697 (quoting S. REP. NO. 95-989, at 21-22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787).
158. *Id.* at 697-98 (quoting S. REP. NO. 95-989, at 21-22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787).

Finally, the Tenth Circuit used the conduct theory to determine that Watson's claim did in fact occur pre-petition, and was thus protected by the Code's automatic stay provision.[159] Since conduct giving rise to Watson's malpractice claim occurred in May 1996, five months before Parker's Chapter 7 filing, Watson's claim arose prepetition.[160] Watson's claim arose on the date Parker committed the malpractice.[161] Therefore, the Tenth Circuit upheld the bankruptcy appellate panel's decision that Watson's claim was a prepetition claim and once again found the claim to be dischargeable.[162]

III. OTHER CIRCUIT APPROACHES: MECHANICAL APPROACH VERSUS LOOKING AT THE DEBTOR'S INTENT

A. *The Sixth Circuit:* In re Madaj,[163] *An Example of the Mechanical Approach*

1. Facts

Two over-generous foster parents ("Creditors") lent their son and his wife money to cover fire damage.[164] While the son may have anticipated repaying the loan initially, the son and his wife ("Debtors") filed Chapter 7 bankruptcy instead.[165] Debtors' petition did not list their parents as creditors,[166] Debtors received a discharge, and the no asset case was closed.[167] Unaware of Debtors' bankruptcy proceedings, Creditors repeatedly asked Debtors for repayment.[168] Creditors' fruitless requests led them to file a state action to recover the loan.[169] Thereafter, Debtors moved to reopen their Chapter 7 case and include the debt to their parents.[170] Debtors claimed that their initial failure to list the creditors was unintentional and caused by a memory lapse.[171] Creditors opposed the reopening and filed suit.[172]

Arguing that Debtors' forgetfulness was insincere and an attempt to defraud, Creditors argued that a debt can only be discharged if it is listed.[173] In essence, Creditors argued that Debtor's failure to list the debt resulted in the nondischarge of their debt.[174] Admittedly, within

159. *In re Parker II*, 313 F.3d at 1269-70.
160. *In re Parker I*, 264 B.R. at 698.
161. *Id.* at 696, 698.
162. *In re Parker II*, 313 F.3d at 1270.
163. Zirnhelt v. Madaj (*In re* Madaj), 149 F.3d 467 (6th Cir. 1998).
164. *In re Madaj*, 149 F.3d at 468.
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*
171. *Id.*
172. *Id.*
173. *Id.*
174. *See id.*

their argument Creditors agree with Debtors that, had the debt been originally filed, it would have been discharged.[175] Additionally, Creditors admit that, because this is a no asset case, Creditors would not have received payment even if they had filed a claim.[176] Thus, Creditors opposed Debtors' reopening of their Chapter 7 case to protect the debt from discharge.[177]

2. Decision

In *In re Madaj*, the Sixth Circuit affirmed the decisions of both the bankruptcy court and the district court in denying Debtor's motion to reopen.[178] Additionally, the Sixth Circuit affirmed the lower court's holdings that, although debtors cannot reopen their bankruptcy proceeding, the debt was discharged.[179] The Sixth Circuit held that it was unnecessary for Debtor to reopen a no asset case to receive a discharge from an omitted debt.[180] Thus, the Sixth Circuit held that it is "pointless" to reopen a no asset case because the scheduling of the debt will have no effect, since the debt has already been discharged.[181]

The Sixth Circuit pointed to section 523(a)(3)(A) as the possible source of the confusion regarding whether it is necessary to reopen a case for a claim to be discharged.[182] Referring to this confusion surrounding section 523(a) of the Code, the Sixth Circuit discussed the intricate operation of section 523(a) as it applies to a Chapter 7 proceeding.[183] In its discussion, the Court found that "even 523(a)(3)(A) does not except an unscheduled debt from discharge if the creditor had notice or actual knowledge of the bankruptcy case in time for timely filing of a proof of claim."[184] The Sixth Circuit further explained that "most of the twists and turns affecting dischargeability" are accorded to the exceptions for fraudulent debts in sections 523(a)(2), (4), and (6).[185] Reiterating that section 523(a)(3)(A) does not apply if the creditor had knowledge of the debtor's bankruptcy proceedings from the scheduling or nontraditional means, the Sixth Circuit emphasized that the exception under section 523(a)(3)(A) revolves around lack of notice, not actual scheduling.[186]

Section 523(a)(3)(A) of the Code excepts from discharge a claim that the debtor did not list, so that the creditor did not receive notice of the bankruptcy proceedings unless the creditor had notice, regardless of

175. *Id.*
176. *Id.*
177. *See id.*
178. *Id.*
179. *Id.*
180. *See id.* at 468-72.
181. *Id.* at 468.
182. *Id.*
183. *See id.* at 469.
184. *Id.* (discussing 11 U.S.C. § 523(a)(3)(A) (1994)).
185. *Id.*
186. *See id.*

the debtor's failure to list the claim.[187] The Sixth Circuit held that the purpose of the section 523(a)(3)(A) exception is to prevent the injustice that would result if a creditor did not have an opportunity to "participate in the distribution of the assets of the estate" in a bankruptcy proceeding.[188] In a no asset case, no injustice will result because there are no assets to distribute.[189] The purpose of the exception in section 523(a)(3)(A) is not relevant to a no asset case because injustice cannot result if there are no assets to distribute.[190] The Sixth Circuit recognized "that creditors may want to add their names to the matrix in the unlikely event that the case is eventually reopened in order to distribute previously undiscovered assets of the estate, but the vast majority of no-asset cases do not involve such plot twists."[191] Thus, the Sixth Circuit held that section 523(a)(3)(A) "operates differently" with a no asset case with no bar date because there is no injustice for lack of notice to the creditor for an unscheduled debt.[192]

The Sixth Circuit found that "there is no effect" in allowing a debtor to reopen a case to schedule an omitted debt.[193] No effect is caused by the reopening because "[a] debtor cannot change the nature of the debt by failing to list it in his petition and schedules."[194] Once a debtor receives discharge pursuant to section 727, "debts are either discharged or they are not discharged . . . ."[195] Section 523(a)(3)(A) cannot save a debt in a no asset case that would have otherwise been dischargeable because the debtor did not list it for any reason.[196] Therefore, the Sixth Circuit held that it is unnecessary to reopen a no asset case for a debt to be discharged.[197]

B. The Eleventh Circuit: In re Baitcher,[198] *An Example of a Court Looking into Debtor's Intent in Failing to Schedule a Claim*

1. Facts

Barbara Baitcher and Daniel Baitcher owned a restaurant, The Flame, Inc.[199] After a series of unfortunate events, The Flame filed a

187. 11 U.S.C. § 523(a)(3)(A) (2000).
188. *In re Madaj*, 149 F.3d at 470. "Without the exception in § 523(a)(3)(A), the debtor could simply deny his uninformed creditors the opportunity to recover from the bankruptcy estate by omitting their debts from the schedule." *Id.* at 469.
189. *See id.* at 470.
190. *See id.*
191. *Id.* at 470 n.3.
192. *Id.* at 470.
193. *Id.* at 472.
194. *Id.*
195. *Id.*
196. *See id.*
197. *Id.*
198. Samuel v. Baitcher (*In re* Baitcher), 781 F.2d 1529 (11th Cir. 1986).
199. *In re Baitcher*, 781 F.2d at 1530.

petition for bankruptcy.[200] After the petition in bankruptcy, the Baitchers were no longer in possession of the restaurant, and a receiver was appointed.[201] After the receiver was appointed, Barbara Baitcher continued to work at The Flame.[202] During this period of time, The Flame's workmen's compensation insurance lapsed.[203] Around the same time, Samuel, a worker, was injured while working at the restaurant.[204] The injuries, coupled with The Flame's lack of workers' compensation insurance, led Samuel to file a suit in state court against both Baitchers for liability.[205]

In 1979, Barbara Baitcher (Baitcher) petitioned for individual bankruptcy.[206] The day before Baitcher petitioned for bankruptcy, Samuel's state action against Baitcher was dismissed.[207] Samuel was not included in Baitcher's petition as a creditor.[208] Baitcher's bankruptcy was discharged in 1980, but Samuel's claim was not discharged because it was not listed.[209] Baitcher's bankruptcy was a no asset case.[210]

In 1981, Samuel received a judgment against Baitcher from the state action.[211] As a result, Baitcher "moved to reopen her bankruptcy, added Samuel's name to the list of creditors, and obtained a new discharge applicable to him."[212] The bankruptcy court allowed Baitcher to reopen the case.[213] Consequently, Samuel moved for summary judgment on the grounds that the complaint was nondischargeable.[214] The bankruptcy court found the complaint was dischargeable and summary judgment was granted in favor of Baitcher.[215] The district court affirmed and Samuel appealed the decisions of both courts.[216]

2. Decision

In *In re Baitcher*, the Eleventh Circuit held that the Code allows a debtor to reopen a bankruptcy and schedule an omitted debt when the debtor failed to schedule the debt originally because of an "honest mistake," but not when the failure was a result of "fraud or intentional de-

200. *Id.*
201. *Id.*
202. *Id.*
203. *Id.*
204. *Id.*
205. *Id.*
206. *Id.* For the remainder of this section, Baitcher will refer only to Barbara Baitcher. Daniel Baitcher is not included in this action. *See id.* at 1530-31.
207. *Id.* at 1530-31.
208. *Id.* at 1530.
209. *Id.*
210. *Id.*
211. *Id.* at 1531.
212. *Id.*
213. *Id.*
214. *Id.*
215. *Id.*
216. *Id.*

sign."[217] In *In re Baitcher*, the Eleventh Circuit adopted an equitable approach for deciding whether to reopen a no asset, no bar date bankruptcy case.[218] For Baitcher to receive a discharge under this equitable approach, the Eleventh Circuit found she must show "absence of fraud or intentional design."[219] The Eleventh Circuit reasoned that inequity would result if the court did not consider the debtor's intent behind omitting the debt.[220] Because Baitcher could not demonstrate lack of fraud or intentional design in omitting the debt on summary judgment, the Eleventh Circuit remanded the case back to the lower courts to decide whether to reopen the case and discharge the debt.[221]

The Eleventh Circuit discussed some of the facts the lower court should look into when analyzing Baitcher's intent for omitting the claim from the bankruptcy.[222] In particular, the Eleventh Circuit pointed to Baitcher's failure to include Samuel's debt in the original petition in light of including other debts owed by The Flame.[223] Another troubling fact to the court was that Baitcher's lawyer filed the bankruptcy claim and also defended the Samuel claim in court at the time Baitcher omitted the claim from list.[224] Both of these facts could point to Baitcher's use of fraud or intentional design in omitting Samuel as a creditor.[225] Thus, the Eleventh Circuit found many possible issues that may prevent a lower court from reopening Baitcher's bankruptcy and discharging the debt.[226] Therefore, the Eleventh Circuit adopted the equitable approach requiring a court to look into the debtor's intent for failing to list a debt before reopening the case and discharging the debt.[227]

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217. *Id.* at 1534 ("[U]nder the new law the old prophylactic rule does not in a no-asset case any more deny a discharge to one who has failed to schedule for reasons of honest mistake, not fraud or intentional design." (internal quotations omitted)).
218. *See id.* at 1533-34.
219. *Id.* at 1534.
220. *See id.*
221. *Id.* at 1535.
222. *Id.* at 1534.
223. *Id.*
224. *Id.* at 1530.
225. *Id.* at 1534.
226. *Id.*
227. *Id.* at 1533-34.

IV. OTHER CIRCUITS' APPROACHES: CONDUCT THEORY VERSUS THE ACCRUAL THEORY

A. *The Fourth Circuit:* Grady v. A.H. Robins Co., Inc.,[228] *An Example of the Conduct Approach*

1. Facts

A.H. Robins Company (Robins) manufactured a contraceptive device, the Dalkon Shield, from 1971 to 1974.[229] After receiving numerous complaints regarding health and safety concerns, Robins discontinued production of the Dalkon Shield in 1974.[230] On August 21, 1985, Robins filed a petition for Chapter 11 reorganization as a result of the "overwhelming number of claims filed against it because of the Dalkon Shield . . . ."[231] Mrs. Grady was a user of the Dalkon Shield.[232] On the same day, August 21, Grady was admitted to the hospital with numerous complaints including abdominal pain.[233] Days later she was diagnosed with pelvic inflammatory disease, which ultimately caused her to undergo a hysterectomy.[234]

Two months later, on October 15, 1985, Grady filed a civil action against Robins.[235] The action was later transferred to the Eastern District of Virginia.[236] Subsequently, Grady filed a motion in the bankruptcy court.[237] In her motion, Grady requested the court to classify her claim as post-petition.[238] If the bankruptcy court determined that Grady's claim did not arise until after Robins filed the petition, then Grady's claim would not be stayed by the automatic stay provision.[239]

The bankruptcy court rejected the accrual approach and adopted the conduct approach in determining that Grady's claim was a pre-petition claim.[240] The court held that "the right to payment under 11 U.S.C. § 101(4)(A) of Mrs. Grady's claim arose when the acts giving rise to the liability were performed and thus the claim was pre-petition under 11 U.S.C. § 362(a)(1)."[241] Because Grady's claim would be pre-petition and

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228. 839 F.2d 198 (4th Cir. 1988).
229. *Grady*, 839 F.2d at 199.
230. *Id.*
231. *Id.*
232. *Id.*
233. *Id.*
234. *Id.*
235. *Id.*
236. *Id.*
237. *Id.*
238. *See id.*
239. *Id.*; *see also* 11 U.S.C. § 362 (a)(1) (1988).
240. *Grady*, 839 F.2d at 199.
241. *Id.*

subject to the automatic stay, Grady appealed to the Fourth Circuit Court of Appeals.[242]

2. Decision

The Fourth Circuit adopted the conduct approach in *Grady v. A.H. Robins Co., Inc.*[243] *Grady* starts with an analysis of the legislative history of section 362 of the Bankruptcy Code (Code).[244] The Fourth Circuit looked to the Congressional history of the Code that relates "[t]he automatic stay is one of the fundamental debtor protections . . . . It gives the debtor a breathing spell from his creditors."[245] Additionally, the Fourth Circuit found that Congress intended the "broadest possible relief in the bankruptcy court."[246] Finding that the legislative history indicates that a court should view the automatic stay provision as fundamental to the Code's broad protection of debtors, the Court found the definition of "claim" in the automatic stay provision should be defined broadly.[247]

Grady argued that her suit did not fall within the definition of "claim" under the automatic stay provision.[248] Grady advocated the definition of "claim" to be when the right to payment for a claim exists.[249] Because state law did not allow her a right to payment until the injury occurred, Grady argued she did not have a claim until after Robins filed the petition with the bankruptcy court.[250] Thus, Grady's argument was that the bankruptcy court should look to state law to define when a claim arises, not federal law.[251] The Fourth Circuit rejected Grady's argument, which would have resulted in the adoption of the accrual approach for determining when a claim arises for purposes of the automatic stay provision.[252]

The Fourth Circuit rejected the accrual approach for several reasons.[253] First, bankruptcy courts do not apply state law: they follow the Bankruptcy Code.[254] "[T]he bankruptcy Code is superimposed upon the

242. *Id.* at 198.
243. *Id.* at 199.
244. *Id.* at 200-01.
245. *Id.* at 200 (quoting S. REP. NO. 95-989, at 54-55 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5840; H.R. REP. NO. 95-595, at 340-41 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6296-97).
246. *Id.* (quoting S. REP. NO. 95-989, at 21-22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5807-08; H.R. REP. NO. 95-595, at 309 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5787, 6266).
247. *Id.*
248. *Id.*
249. *See id.* at 201.
250. *Id.*
251. *Id.* at 200-01.
252. *See id.* at 201.
253. *Id.*
254. *Id.* at 201-02.

law of the State which has created the obligation."[255] Accordingly, the Fourth Circuit found that the automatic stay provision of the Code is the pertinent law for determining when a claim arises, not the law of the state.[256] Once again, the Court stressed the importance of the automatic stay provision, stating: "Absent a stay of litigation against the debtor, dismemberment rather than reorganization would, in many or even most cases, be the inevitable result."[257] Thus, the Fourth Circuit determined the Code would be the prevailing law because of the high importance of protecting the debtor from creditors, which is demonstrated by the automatic stay provision.[258]

Next, the Fourth Circuit looked to the words of the automatic stay provision.[259] "Section 362(a)(1) provides for an automatic stay of, among other things, judicial action against the debtor ' . . . to recover a claim against the debtor that arose before the commencement of the case under this title.'"[260] The Fourth Circuit also looked to Section 101(4)(A) which "defines a claim to be a 'right to payment whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured.'"[261] The court then went through the same definition analysis as the Tenth Circuit in *In re Parker II*, discussed above in section II A. 2. of this survey.[262] The Fourth Circuit found that Grady's claim was contingent because it was a claim conditioned upon an uncertain future event.[263] Thus, a contingent claim includes a claim in which no right to immediate payment exists.[264]

The Fourth Circuit determined that Congress intended to include a contingent claim as a right to payment within the protection of section 362(a)(1)'s automatic stay.[265] A broad definition of "claim" was consistent with the legislative history intending that bankruptcy allow a debtor broad relief from creditors.[266] Finally, the Fourth Circuit considered that the bankruptcy court probably would have been able to classify Grady's claim as pre-petition by use of its equitable powers under 11 U.S.C. §

255. *Id.* at 202 (referring to Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 162 (1946) ("In determining what claims are allowable and how a debtor's assets shall be distributed, a bankruptcy court does not apply the law of the state where it sits.")).
256. *See id.* at 201-02.
257. *Id.* at 202.
258. *Id.*
259. *Id.*
260. *Id.* (quoting 11 U.S.C. § 362(a)(1) (1988)).
261. *Id.* (quoting 11 U.S.C. § 101(4)(A) (1988) (currently codified at 11 U.S.C. § 101(5)(A) (2000)).
262. *Id.*; *see supra* notes 147-53 and accompanying text.
263. *Grady*, 839 F.2d at 202-03.
264. *Id.* at 203.
265. *Id.*
266. *Id.*

105(a).[267] Therefore, the Fourth Circuit found that the conduct approach was the proper approach to determine when a claim arose.[268]

B. Third Circuit: In re M. Frenville Co.,[269] *An Example of the Accrual Approach*

1. Facts

A&B was an accounting firm employed by M. Frenville Co.[270] A&B prepared certified financial statements for Frenville during 1978 and 1979.[271] In 1980, Frenville filed for Chapter 7 bankruptcy.[272] Subsequently, bank investors of Frenville filed an action against A&B in 1981 alleging, among other things, that A& B negligently and recklessly prepared Frenville's financial statements.[273] In 1983, as a result of the suit by the banks, A&B sought to include Frenville as a third-party defendant.[274] A&B filed a petition in the bankruptcy court, seeking a declaration that the automatic stay provision of section 362(a)(1) did not bar the claim.[275] Both the bankruptcy court and the district court held that the automatic stay provision barred A&B's claim against Frenville.[276] A&B appealed to the Third Circuit.[277]

2. Decision

The Third Circuit held that A&B's claim was not barred by the automatic stay provision of section 362(a)(1).[278] The Third Circuit adopted the accrual approach to determine the date a claim arises for purposes of the automatic stay provision.[279] The Court held that "[o]nly proceedings that could have been commenced or claims that arose before the filing of the bankruptcy petitions are automatically stayed."[280] According to the Third Circuit, focusing on the harm, not the conduct, was the Congressional intent behind the automatic stay provision.[281] Thus, the Third Circuit, searching for the date the harm occurred, looked to

267. *Id.* (referring to 11 U.S.C. § 105(a) (1988)).
268. *Id.*
269. Avellino & Bienes v. M. Frenville Co. (*In re* M. Frenville Co.), 744 F.2d 332 (3rd Cir. 1984).
270. *In re M. Frenville Co.*, 744 F.2d at 333.
271. *Id.*
272. *Id.*
273. *Id.*
274. *Id.* at 333-34.
275. *Id.*
276. *Id.* at 334.
277. *Id.* at 333.
278. *Id.* at 337.
279. *Id.*
280. *Id.* at 335.
281. *Id.*

whether A&B could bring a claim prior to when the bankruptcy petitions were filed.[282]

To determine whether A&B could bring a claim prior to Frenville's filing for bankruptcy, the Third Circuit looked to the Code's definition of "claim."[283] Unlike the Fourth and Tenth Circuits, the Third Circuit determined that the Code's definition of "claim" as a "right to payment" was the "threshold requirement" for determining when a claim may be brought for purposes of the automatic stay provision.[284] Because the Code does not define when a right to payment arises, the Third Circuit determined that, absent "overriding federal law," the court must look to state law.[285]

The Third Circuit looked to New York law to determine when A&B was able to bring a claim for contribution or indemnity against Frenville.[286] New York law allows a claim for contribution or indemnity to be commenced "at the time the defendant . . . serves his answer in the suit brought by the plaintiff . . . ."[287] Under New York law, A&B could not commence its action for indemnity against Frenville until the suit was instituted by the banks against A&B.[288] The banks instituted their suit against A&B fourteen months after Frenville began bankruptcy proceedings.[289] Therefore, the Third Circuit determined the claim arose post-petition and was not barred by the automatic stay provision.[290]

V. ANALYSIS

In *In re Parker II*, the Tenth Circuit decided on two approaches for interpreting the Bankruptcy Code: the mechanical approach for reopening a case under section 523(a)(3)(A) in a no asset, no bar date Chapter 7 bankruptcy, and the conduct approach for purposes of the automatic stay provision.[291] By adopting both the mechanical and conduct approaches, the Tenth Circuit is protecting the debtor and promoting the "fresh start" philosophy of the Bankruptcy Code.[292] The mechanical approach towards reopening a bankruptcy case under section 523(a)(3)(A) protects the debtor by not requiring the no asset, no bar date bankruptcy to be re-

282. *Id.*
283. *Id.* at 336.
284. *Id.* ("At first glance, A & B might be thought to have had an unliquidated, contingent, unmatured and disputed claim pre-petition. While all of these adjectives may describe A & B's cause of action against the Frenvilles, the threshold requirement of a claim must first be met -- there must be a 'right to payment.'" (quoting 11 U.S.C. § 101(4)(A) (1982)).
285. *Id.* at 337.
286. *Id.* at 335.
287. *Id.*
288. *See id.* at 337.
289. *Id.*
290. *Id.* at 337-38.
291. Watson v. Parker (*In re* Parker II), 313 F.3d 1267, 1268-69 (10th Cir. 2002), *cert. denied*, 124 U.S. 429 (2003).
292. *See In re Parker II*, 313 F.3d at 1268-69.

opened for a debtor to receive a discharge from an omitted claim.[293] Consequently, a debtor will not be required to explain why she omitted the debt from the original bankruptcy schedule.[294] Additionally, the mechanical approach protects the debtor by holding that a section 523(a)(3)(A) nondischarge exception for lack of timely notice does not apply in a no asset, no bar date bankruptcy.[295] The conduct approach to the Code's automatic stay provision also protects the debtor, by allowing an expansive definition of a "pre-petition" claim that reaches to all conduct prior to the bankruptcy proceeding, regardless of whether the creditor could have filed the claim prior to the bankruptcy.[296] Thus, in *In re Parker II*, the Tenth Circuit's holding regarding approaches to interpreting the Code show the Tenth Circuit's desire to protect the debtor and promote the Code's fresh start philosophy.[297]

The mechanical approach allows a debtor in a Chapter 7 no asset, no bar date bankruptcy to receive a discharge for an omitted debt without reopening the claim.[298] Because section 523(a)(3)(A) does not apply in a no asset, no bar date Chapter 7 case, courts using the mechanical approach hold that reopening the case is not required for a discharge under section 727 of the Code.[299] By not requiring a debtor to reopen the case, the court does not require the debtor to explain why the debt was originally omitted from the bankruptcy schedule.[300] The court will not inquire into the debtor's intent for failing to schedule the claim.[301] When a court does not inquire into the debtor's intent, it allows a debtor to easily receive a discharge for an omitted debt that would otherwise not be dischargeable.[302] By failing to list a debt in the original schedule, a debtor does not change the "nature of the debt."[303] Consequently, an omitted debt will be nondischargeable only if it meets one of the section 523 exceptions, excluding section 523(a)(3)(A) which holds a debt nondischargeable for lack of notice.[304] The mechanical approach thus allows a favorable result to a debtor that has omitted a creditor.[305]

Recall in *In re Madaj*, the debtors failed to list a debt owed to their own foster parents.[306] The debtors claimed this failure to be simply an act

293. *See* Edgar, *supra* note 13, at 9-12.
294. *See* Watson v. Parker (*In re* Parker I), 264 B.R. 685, 694 (B.A.P. 10th Cir. 2001), *aff'd*, 313 F.3d 1267 (10th Cir. 2002).
295. *See* 4 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 76.06 (2003).
296. *See* Azaria, *supra* note 81, at 213-14.
297. *See In re Parker II*, 313 F.3d at 1268-69.
298. *Id.* at 1269 (quoting *In re Parker I*, 264 B.R. at 695).
299. *In re Parker I*, 264 B.R. at 694.
300. *See id.*
301. *In re Parker II*, 313 F.3d at 1269.
302. *See id.* at 1268-69 (quoting *In re Parker I*, 264 B.R. at 694).
303. Zirnhelt v. Madaj (*In re* Madaj), 149 F.3d 467, 472 (6th Cir. 1998).
304. *In re Madaj*, 149 F.3d at 472.
305. *See id.*; *In re Parker II*, 313 F.3d at 1268-69 (citing *In re Parker I*, 264 B.R. at 694-95).
306. *In re Madaj*, 149 F.3d at 468.

of a forgetful memory.[307] The parents, the creditors, argued that this memory failure was not credible because of their persistent reminder to the debtors of the loan.[308] The Sixth Circuit adopted the mechanical approach in *In re Madaj*.[309] Applied to the facts of *In re Madaj*, the mechanical approach prevented the court from further inquiring into the credibility of the debtor's forgetfulness because the debt would have been discharged if originally listed.[310] An inquiry into the debtor's intent for failing to schedule the creditors may have unveiled just how incredible a foster son's memory failure of a debt owed to his own parents would be.[311] A court, having inquired into these circumstances of the debtors' forgetfulness, may have found fraud or intentional design and refused to reopen the bankruptcy and discharge the debt.[312] Thus, *Madaj* illustrates the favorable effect the mechanical approach has toward debtors.

In re Parker II also illustrates the protection the mechanical approach offers debtors.[313] In *In re Parker II*, the debtor attorney was sued for malpractice by his creditor client.[314] During a deposition the debtor told the creditor he "made the conscious decision" to omit the claim from his bankruptcy to allow the creditor recourse against him.[315] Perhaps because of a change of heart, the debtor later moved to reopen his chapter 7 no asset, no bar date case to add the omitted debt and receive a discharge.[316] By adopting the mechanical approach, the Tenth Circuit did not inquire into whether it was equitable for the debtor to have a change of heart and schedule the omitted debt.[317] Thus, regardless of why the debtor failed to list the debt originally, the case was reopened and the debt will be discharged unless an exception other than section 523(a)(3)(A) applies.[318] Therefore, *In re Parker II* also illustrates the protection the mechanical approach offers the debtor.[319] In *In re Parker II*, the mechanical approach literally protected the debtor from his own admission that he intentionally "forgot" to list the debt.[320]

The Tenth Circuit's adoption of the conduct approach to determine if a claim is pre-petition or post-petition, for purposes of the automatic

307. *Id.*
308. *Id.*
309. *Id.* at 472.
310. *Id.*
311. *See id.* at 468.
312. *E.g.*, Samuel v. Baitcher (*In re* Baitcher), 781 F.2d 1529, 1534 (11th Cir. 1986) (finding "intentional design, if not fraud" upon inquiry into the debtor's forgetfulness in omitting a creditor from the schedule).
313. *See In re Parker II*, 313 F.3d at 1268-69 (citing *In re Parker I*, 264 B.R. at 694-95).
314. *In re Parker I*, 264 B.R. at 690-91.
315. *Id.* at 691.
316. *Id.*
317. *See In re Parker II*, 313 F.3d at 1269.
318. *In re Parker I*, 264 B.R. at 694-95.
319. *See id.*
320. *See id.*

stay provision of the Code, also serves to protect debtors.[321] When a claim is classified as pre-petition, a debtor is afforded relief from creditors under the Code's automatic stay provision.[322] A debtor receives protection from claims classified as pre-petition under the Code and does not receive protection from post-petition claims.[323] By adopting the conduct approach rather than the accrual approach to determine whether a claim is pre-petition or post-petition, the Tenth Circuit allows more claims to be classified as pre-petition than the accrual approach allows.[324] The conduct approach uses federal, rather than state, law. The use of federal law keeps claims from being classified as post-petition just because state law would prevent claims from being brought until after the bankruptcy proceeding.[325] Thus, the conduct approach protects debtors by not creating a loophole for pre-petition conduct to be classified as a post-petition claim under state law.[326]

In re M. Frenville Co., decided by the Third Circuit, the only circuit that uses the accrual method, illustrates the greater protection the conduct approach grants debtors in comparison to the accrual approach. Recall in *In re M. Frenville Co.*, the creditor A&B worked for the debtor Frenville as an independent auditor.[327] Frenville later petitioned for Chapter 7 bankruptcy.[328] When A&B was sued for allegedly preparing false financial statements for Frenville, A&B sought indemnification from Frenville.[329] The conduct giving rise to the claim was the creation of false financial statements, and occurred prior to Frenville filing for bankruptcy.[330] If the Court had followed the conduct approach, A&B's claim would have been considered a pre-petition claim and the debtor Frenville would have received relief from the Code's automatic stay provision. Instead, using the accrual approach, the court looked to state law to determine whether the creditor could have brought the indemnification cause of action prior to the bankruptcy.[331] Under the accrual approach, because A&B could not have brought their claim against Frenville until after the date of the bankruptcy proceedings, A&B's claim was classified as post-petition and not subject to the automatic stay provision.[332] Thus, in *Frenville*, the debtor would have received greater protection had the

321. *See In re Parker II*, 313 F.3d at 1269-70.
322. Azaria, *supra* note 81, at 209.
323. *Id.* at 207-08.
324. *See* John W. Ames et al., *Toxins-Are-Us, Future Claimants in Mass Tort Bankruptcy Cases*, 13 AM. BANKR. INST. J. 8, 8 n.1 (1994).
325. *See id. See generally* Avellino & Bienes v. M. Frenville Co. (*In re* M. Frenville Co.), 744 F.2d 332 (3d Cir. 1984) (applying New York law to resolve a bankruptcy issue).
326. *See* Ames et al., *supra* note 324, at 8 n.1.
327. *In re M. Frenville Co.*, 744 F.2d at 333.
328. *Id.*
329. *Id.* at 333-34.
330. *Id.* at 334.
331. *Id.* at 337.
332. *Id.*

court used the conduct approach for purposes of the automatic stay provision of the Code.

In re Parker II also illustrates the protection the conduct approach affords the debtor under the automatic stay provision.[333] Watson, the creditor, argued that Kansas law prevented her from bringing a cause of action until after Parker, the debtor, filed bankruptcy.[334] The Tenth Circuit, by adopting the conduct approach in *In re Parker II*, did not look to state law to determine whether the creditor's claim was pre-petition or post-petition.[335] Thus, the Tenth Circuit protected the debtor by adopting the conduct approach because the accrual approach to the automatic stay provision may have classified the claim as post-petition, precluding discharge of the debt in the bankruptcy proceeding.

CONCLUSION

In *In re Parker II*, the Tenth Circuit chose two paths of interpreting the Bankruptcy Code. Both of the Tenth Circuit's chosen paths of interpretation show the Tenth's Circuit's desire to protect the debtor and promote the Code's "fresh start" philosophy. The Tenth Circuit's adoption of the mechanical approach protects the debtor in a Chapter 7 no asset, no bar date bankruptcy by not requiring the debtor to reopen the case to receive a discharge. The mechanical approach further protects the debtor by finding that section 523(a)(3)(A) cannot change an otherwise dischargeable debt into a nondischargeable debt because of the debtor's failure to originally list it. Finally, the conduct approach the Tenth Circuit adopted in *In re Parker II* protects the debtor by not creating a loophole for pre-petition conduct to be classified a post-petition claim under state law. It does not allow state law to reach into the Code and create the possibility of varying levels of debtor protection depending upon the state law that applies. In *In re Parker II*, the Tenth Circuit not only chose the most traveled paths of Bankruptcy Code interpretation, but also the paths protecting the debtor and the philosophy of the Code.

*Lydia M. Floyd**

333. *See In re Parker II*, 313 F.3d at 1269-70.
334. *In re Parker I*, 264 B.R. at 695.
335. *Id.* at 697.

* J.D. Candidate, 2005, University of Denver College of Law. I would like to take this opportunity to thank my father, James Floyd, for his help with this Survey, and Tom DeVine for his help in the process of putting this Survey together.

COLORADO V. SUNOCO: THE TENTH CIRCUIT'S STAND ON STATUTE OF LIMITATIONS FOR CERCLA COST RECOVERY ACTIONS

INTRODUCTION

In 1980, the United States Congress responded to a series of national environmental disasters[1] by passing the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA").[2] Congress wrote the legislation in hopes of protecting human health and the environment by providing a "comprehensive response and financing mechanism to abate and control the vast problems associated with abandoned and inactive hazardous waste disposal sites."[3] In 1986, Congress amended CERCLA with the Superfund Amendments and Reauthorization Act ("SARA"), and further facilitated the "prompt clean-up of hazardous waste sites"[4] by enhancing the effectiveness of CERCLA's primary financing tool, the Superfund.[5] SARA broadened the extent of the Superfund as a financial resource because it allowed for payments into the fund from producers of chemicals and petroleum products, often in exchange for CERCLA liability exemptions.[6] In essence, the Superfund provides the government with the capital necessary to immediately respond to toxic releases at dangerous hazardous waste sites, without initially having to deal with the often intricate and lengthy process of assigning liability.[7]

After the government spends Superfund dollars to facilitate response at a hazardous substance release site, it may then concentrate its efforts on the assignment of liability, using CERCLA's cost-shifting provisions.[8] The Superfund Amendments of 1986 ensure that after the gov-

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1. *See, e.g.*, Pub. Serv. Co. of Colo. v. Gates Rubber Co., 175 F.3d 1177, 1181 (10th Cir. 1999) ("Congress enacted CERCLA, 42 U.S.C. §§ 9601-9675, in the wake of the Love Canal disaster . . . .").

2. 42 U.S.C. §§ 9601-75 (2000).

3. H.R. REP. NO. 96-1016, pt. 1, at 1 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6119, 6125.

4. *See generally* Brock Elliot Czeschin, United States v. Navistar International Transportation Corp.*: Seventh Circuit Bars Government's CERCLA Claim Based on Violation of the Statute of Limitations*, 10 VILL. ENVTL. L.J. 399, 429 (1999). "Congress enacted . . . the Superfund Amendments and Reauthorization Act (SARA) . . . to correct perceived inadequacies in the CERCLA framework." *Id.* at 399 n.2.

5. *Id.* at 429. In January of 2002, Congress again amended CERCLA with the "Brownfields Amendments." United States v. Domenic Lombardi Realty, Inc., 290 F. Supp. 2d 198, 209 (D.R.I. 2003). These amendments provided certain exemptions for CERCLA liability, namely in allowing property owners or surveyors to re-develop certain CERCLA sites without fear of facing liability. *See Domenic Lombardi Realty, Inc.*, 290 F. Supp. 2d at 209.

6. *See* Ulvestad v. Chevron U.S.A., Inc., 818 F. Supp. 292, 293-94 (C.D.Cal. 1993); *see also* Consumers Power Co. v. Dep't of Treasury, 597 N.W.2d 274, 281 (Mich. Ct. App. 1999).

7. *See Gates Rubber Co.*, 175 F.3d at 1181.

8. *See* Morrison Enters. v. McShares, Inc., 302 F.3d 1127, 1132 (10th Cir. 2002).

ernment promptly responds to a release or threat of release of a hazardous substance, it can then "shift the cost of environmental response from the taxpayers to the parties who benefitted [sic] from the wastes that caused the harm."[9] Further, CERCLA imposes retroactive, strict, and joint and several liability upon several classes of potentially responsible parties ("PRPs").[10] Such liability may attach to:

> (1) the owner and operator of a vessel or a facility [where the release occurred],
>
> (2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of,
>
> (3) any person who . . . arranged for disposal or treatment . . . of hazardous substances owned or possessed by such person, . . . and
>
> (4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities . . . .[11]

Many courts have found that Congress intended the potential liability under CERCLA to be quite expansive.[12] Because CERCLA imposes joint and several liability, a single PRP may be held liable for all costs relating to the cleanup of the hazardous substance release, regardless of that party's degree of responsibility.[13] However, Congress did provide PRPs various forms of equitable relief, permitting PRPs to spread the response costs among themselves.[14] If found liable, a PRP may invoke either the contribution provisions of the statute, whereby "[a]ny person [that is held liable under the statute] may seek contribution from any other person who is liable or potentially liable,"[15] or the PRP may choose to initiate its own cost recovery action against another PRP.[16] By allowing PRPs to initiate CERCLA cost recovery actions themselves, Congress provided an avenue through which response costs are spread only among the responsible parties, sparing taxpayers the burden of financing the cleanup of hazardous wastes.[17]

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9. *Gates Rubber Co.*, 175 F.3d at 1181.
10. *Morrison Enters.*, 302 F.3d at 1132-33.
11. 42 U.S.C. §§ 9607(a)(1)-(4).
12. *See* Aaron A. Garber, *The PRP, the Section 106 Administrative Order, the Contribution Claim, and CERCLA's Statute of Limitations: A Complete Statutory Analysis*, 16 TEMP. ENVTL. L. & TECH. J. 115, 121 (1997).
13. *Id.* at 120.
14. *See* id.
15. 42 U.S.C. § 9613(f)(1).
16. Garber, *supra* note 12, at 120 ("Jurisdictions are split over who may bring section 107 [i.e., 42 U.S.C. § 9607] cost-recovery actions. Since the adoption of SARA, some jurisdictions have granted section 107 cost-recovery actions only to voluntary or innocent parties; thereby, limiting a PRP's right to recover clean-up costs to section 113 [i.e., 42 U.S.C. § 9613] contribution claims.").
17. *Id.* at 118.

It is clear that under CERLCA, Congress intended for PRPs, not taxpayers, to bear the costs of all responses to hazardous substance releases into the environment.[18] To protect PRPs from perpetual liability, Congress incorporated a statute of limitations into CERCLA, which limits the timeframe during which the government or private individuals may pursue cost recovery actions.[19] CERCLA's statute of limitations is said to both encourage the "timely clean-up of affected sites and to ensure replenishment of the [Super]fund . . . ."[20]

Some courts have found CERCLA's statute of limitations fundamentally vague.[21] However, where the interpretation of CERCLA's statute of limitations is at issue in a case, courts traditionally have construed the statute of limitations in favor of the government.[22] Courts have adopted such a construction to further the underlying structures and policies Congress intended in passing the law, primarily, the notion that PRPs, not taxpayers, should bear the costs of hazardous substance cleanup.[23] Courts have interpreted CERCLA as a "broad remedial statute,"[24] mandating that "those who benefit financially from a commercial activity internalize the environmental costs of the activity as a cost of doing business."[25] Although it appears that reasonable policy concerns would encourage courts to construe CERCLA's statute of limitations in favor of governmental cost recovery, the Tenth Circuit Court of Appeals recently rejected such a construction in *Colorado v. Sunoco, Inc.*[26]

The Tenth Circuit's decision in *Sunoco* is questionable because of its departure from the reasoning many courts have adopted in construing CERCLA's statute of limitations. This comment will first examine CERCLA's statute of limitations as applied to both removal and remedial actions. Most courts typically lend deference to administrative bodies in characterizing such actions, as was done by the Tenth Circuit in *Sunoco*.[27] In light of the traditional deference afforded to agency characterizations, one would assume that a court should also defer to the Environmental Protection Agency's ("EPA") *application* of statutes of limitation according to its preferred characterizations, such as the "operable units" characterization at issue in *Sunoco*.[28] This comment will also examine the Tenth Circuit's deference to the EPA's characterizations of response actions at the *Sunoco* site. Next, this comment will contrast that degree of

18. United States v. Manzo, 182 F. Supp. 2d 385, 403 (D.N.J. 2000).
19. 42 U.S.C. §§ 9613(g)(2)(A), (B).
20. United States v. Navistar Int'l Transp. Corp., 152 F.3d 702, 707 (7th Cir. 1998).
21. *E.g.*, Kelley v. E.I. DuPont De Nemours & Co., 17 F.3d 836, 842 (6th Cir. 1994) (applying presumptions to CERCLA's statute of limitations because of perceived statutory ambiguity).
22. *See, e.g., Manzo*, 182 F. Supp. 2d at 403.
23. *Id.*
24. B.F. Goodrich v. Betkoski, 99 F.3d 505, 514 (2d Cir. 1996) (internal quotations omitted).
25. *B.F. Goodrich*, 99 F.3d at 514 (internal quotations omitted).
26. 337 F.3d 1233, 1241-42 (10th Cir. 2003).
27. *Sunoco*, 337 F.3d at 1243.
28. *See id.*

deference with the court's less deferential stance toward the EPA's application of CERCLA's statute of limitations to separate "operable units" of a CERCLA site. Further, this comment will examine and contrast other jurisdictions' treatment of the "operable units" issue, and address the pragmatic reasoning and policy concerns underlying those courts' decisions. Finally, this comment will evaluate the negative implications of the Tenth Circuit's decision in *Sunoco*—for the environment, taxpayers, and responsible parties alike.

I. CERCLA'S STATUTE OF LIMITATIONS AS APPLIED TO SEPARATE OPERABLE UNITS

A. *Background: CERCLA's Statute of Limitations for Cost Recovery Actions*

For purposes of applying CERCLA's statute of limitations, 42 U.S.C. § 9613(g)(2), Congress divided response activities into two categories: removal actions and remedial actions.[29] A removal action generally "costs less, takes less time, and is geared to address an immediate release or threat of release [of a hazardous substance]."[30] Therefore, CERCLA's statute of limitations requires that the initial cost recovery suit for a removal action be filed within three years after the completion of that action.[31] A remedial action is typically more comprehensive, implementing a permanent solution to the release or threatened release of hazardous substances at the site.[32] Remedial actions are often significantly more costly and time consuming than removal actions, and consequently Congress mandated that a government entity or private party must initiate the cost recovery suit for a remedial action within six years "after initiation of physical on-site construction of the remedial action . . . ."[33] Notably, Congress also structured the statute of limitations in a flexible manner, anticipating the complexity and long-term nature of site cleanups, along with the potential for unforeseen future costs commonly associated with CERCLA response actions.[34] Such flexibility is exhibited in 42 U.S.C. § 9613(g)(2), which requires that the court hear an initial cost recovery action prior to issuing a declaratory judgment, allowing the plaintiff to file subsequent cost-recovery actions to recapture further response costs incurred at the site.[35] A party must commence a subsequent

29. 42 U.S.C. §§ 9613(g)(2)(A), (B).
30. Pub. Serv. Co. of Colo. v. Gates Rubber Co., 175 F.3d 1177, 1182 (10th Cir. 1999).
31. 42 U.S.C. § 9613(g)(2)(A).
32. *Gates Rubber Co.*, 175 F.3d at 1182.
33. 42 U.S.C. § 9613(g)(2)(B). The section goes on to state that where remedial actions begin within three years of completion of the removal action on the same site, a party may recover the removal costs in the same action as that brought to recover the remedial costs. *Id.*
34. *Id.*
35. *Id.*

action to recover additional costs "no later than 3 years after the date of completion of all response action."[36]

B. Degree of Deference Lent to the Environmental Protection Agency in Determining Appropriate Response to Hazardous Substance Releases

In providing the Environmental Protection Agency ("EPA") with two means of responding to the release of hazardous substances at a particular site, Congress declared that EPA's decision on the matter should receive a substantial degree of deference from courts. In 42 U.S.C. § 9613(j)(2), Congress set forth the standard it deemed appropriate for judicial review of EPA's determination of a proper response, in declaring that "the court shall uphold the President's decision in selecting the response action unless the objecting party can demonstrate . . . that the decision was arbitrary and capricious . . . ."[37]

However, some courts have lent somewhat of a lesser degree of deference to EPA in both its characterizations of response actions and in its interpretation of environmental laws.[38] Although CERCLA does grant EPA substantial deference in choosing methods of response, CERCLA does not directly speak to the appropriate standard that courts should utilize when reviewing EPA's characterizations of response actions.[39] In *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, the United States Supreme Court ruled that where a "statute is silent or ambiguous with respect to the specific issue," the proper standard of review is whether "the agency's answer is based on a permissible construction of the statute."[40] Courts grant such a wide degree of deference only in cases where "Congress delegated authority to the agency generally to make rules carrying the force of law," and where the agency's determination in question "was promulgated in the exercise of that authority."[41]

Not all agency actions or decisions may warrant *Chevron*-type deference.[42] However, EPA characterizations of response actions will often carry at least some weight on judicial review.[43] Courts base this lesser degree of deference on *Skidmore v. Swift & Co.*, where the United States Supreme Court held that an agency's rulings and opinions are due at least some weight, being "made in pursuance of official duty, based upon

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36. *Id.* Case law suggests that no statute of limitations applies where a PRP seeks contribution from another PRP. *See* Garber, *supra* note 12, at 122.

37. 42 U.S.C. § 9613(j)(2).

38. *See, e.g.*, American Wildlands v. Browner, 260 F.3d 1192, 1196-97 (10th Cir. 2001); *see also* United States v. Navistar Int'l Transp. Corp., 152 F.3d 702, 712 (7th Cir. 1998).

39. Colorado v. Sunoco, Inc., 337 F.3d 1233, 1243 (10th Cir. 2003).

40. Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843 (1984).

41. United States v. Mead Corp., 533 U.S. 218, 226-27 (2001). Courts typically refer to this degree of deference as "*Chevron* deference." *Mead Corp.*, 533 U.S. at 226.

42. *See Sunoco*, 337 F.3d at 1243.

43. *Id.* (holding that because of EPA's "expertise in selecting and executing removal and remedial actions," agency characterizations of those actions are due at least some weight).

more specialized experience and broader investigations" than what are likely to arise in a courtroom.[44]

Courts may either defer to EPA characterizations as carrying the force of law, or consider them with somewhat lesser weight.[45] Either way, it is clear that in furthering the statutory purposes behind CERCLA, both Congress and the Supreme Court intended that an EPA characterization made in the course of responding to a hazardous substance release, such as the characterization of a removal versus a remedial action, deserves at least some deference by a court reviewing those agency decisions.[46]

C. The Environmental Protection Agency's Characterization of Operable Units

The release of hazardous substances into the environment poses a substantial risk to human health and the environment.[47] Governmental response to such releases should be rapid and thorough.[48] It seems apparent that courts should lend at least some deference to the governmental agency's decisions, expertise, and characterizations necessary to successfully carry out that response.[49] One frequently disputed characterization made in relation to CERCLA response actions is EPA's organization of a Superfund site into 'operable units,' and EPA's separate application of CERCLA's statutes of limitation thereto.[50]

The EPA will approach a site where a hazardous substance release threatens to occur or is occurring, evaluate possible cleanup options, and issue a final Record of Decision ("ROD") to officially memorialize the response decision.[51] A single Superfund site may contain several types of waste requiring differing methods of treatment, or the waste may contaminate several types of media; therefore, a ROD may set forth multiple response actions for a single site, as is suggested by 42 U.S.C. § 9621(d).[52] Where a site requires separate "phases" of remedial action, the

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44. Skidmore v. Swift & Co., 323 U.S. 134, 139 (1944). Courts typically refer to this type of deference as "*Skidmore* deference." *See, e.g., Gates Rubber Co.*, 175 F.3d at 1181.

45. *Skidmore*, 323 U.S. at 139-40.

46. *See Sunoco*, 337 F.3d at 1243.

47. *Gates Rubber Co.*, 175 F.3d at 1181(quoting H.R. REP. NO. 96-1016, pt. I, at 1 (1980), *reprinted in* 1980 U.S.C.C.A.N. 6119, 6125).

48. *Id.* (citing OHM Remediation Servs. v. Evans Cooperage Co., 116 F.3d 1574, 1578 (5th Cir. 1997)).

49. *See Skidmore*, 323 U.S. at 139-40.

50. *See, e.g., Sunoco*, 337 F.3d at 1241; United States v. Manzo, 182 F. Supp. 2d 385, 399 (D.N.J. 2000).

51. *Manzo*, 182 F. Supp. 2d at 401. However, a ROD is required only in cases where the EPA places the site on the National Priorities List ("NPL"). United States v. Ambroid Co., 34 F. Supp. 2d 86, 89 (D.Mass. 1999). If the site is not on the NPL, and depending upon the nature of the response action, the EPA may choose to issue an "Action Memorandum." *See Ambroid Co.*, 34 F. Supp. 2d at 90.

52. *Manzo*, 182 F. Supp. 2d at 401 (citing 42 U.S.C. § 9621(d)). Reports accompanying the SARA legislation suggested that the agency should issue a separate ROD for "'each separate and

EPA has commonly labeled those phases as "operable units,"[53] defined as:

> a discrete action that comprises an incremental step toward comprehensively addressing site problems. This discrete portion of a remedial response manages migration, or eliminates or mitigates a release, threat of a release, or pathway of exposure. The cleanup of a site can be divided into a number of operable units, depending on the complexity of the problems associated with the site. Operable units may address geographical portions of a site, specific site problems, or initial phases of an action, or may consist of any set of actions performed over time or any actions that are concurrent but located in different parts of a site.[54]

In facilitating cleanup of a hazardous substance, in encouraging equitable remedies in assigning liability, and in support of Congress' intent to create economic disincentives for businesses engaging in activities that threaten human health and the environment, courts have addressed and consequently accepted the EPA's characterization of operable units as an essential tool in the comprehensive remedial design.[55] Courts have found that when EPA encounters a complex CERCLA site, "it is beneficial to divide response actions into different operable units and RODs because EPA is therefore able to move quickly to reduce health and environmental risks while continuing the process of studying other matters on the site."[56]

Not only does the division of response action into operable units aid the EPA in cleanup, but operable units can also help in apportioning liability between various PRPs in subsequent cost recovery or contribution actions.[57] At a Superfund site where numerous substances are present and where several PRPs are potentially liable, it may be true that a single PRP contributed to the release of a particular substance, or it may have released that substance in one particular geographic portion of the site.[58] When the EPA divides its response actions into operable units, it will do so according to the perceived ease of dealing with various substances individually, or in separating response action by geographical area.[59] Therefore, the costs accrued in response to a particular operable unit will

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distinct phase of a response action . . . .'" *Id.* at 402 (quoting H.R. CONF. REP. NO. 99-962, at 224 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3276, 3317).

53. *Id.* at 402.

54. *Id.* (quoting 40 C.F.R. § 300.5 (2000)).

55. *See, e.g., id.*

56. *Id.* at 403.

57. Interview with Nancy Mangone, Enforcement Attorney, United States EPA Region VIII, in Denver, Colo. (Nov. 4, 2003).

58. *Id.*

59. *Id.*

be more accurately known, and more fairly apportioned among PRPs based upon their actual liability.[60]

In recognizing the important role that operable units play both to the EPA and to PRPs, some courts have sustained the separate application of CERCLA's statute of limitations upon each operable unit of a remediation plan.[61] However, in its recent *Sunoco* decision, the Tenth Circuit disagreed with the reasoning of these courts, and narrowly construed the statute of limitations provisions of CERCLA.[62]

D. Tenth Circuit: Colorado v. Sunoco

1. Facts

The *Sunoco* case was filed in the United States District Court for the District of Colorado.[63] In January 2001, the State of Colorado brought a cost-recovery action under CERCLA § 107 against a series of defendants, including A.O. Smith Corporation, ASARCO, Inc., Bechtel Corporation, and Sunoco, Inc.[64] The District Court granted the defendant corporations' ("Sunoco") motion for summary judgment, holding that Colorado's claims were time-barred by CERCLA's six-year statute of limitations for remedial actions.[65] Colorado appealed the judgment, and with the United States filing as amicus curiae, the Tenth Circuit heard the case on August 5, 2003.[66]

In *Sunoco*, the State of Colorado sought to recover costs accrued in cleaning up mine waste and contaminated water that had originated from the abandoned Summitville mine site in southern Colorado.[67] At the filing of the suit, cleanup at the Summitville site was ongoing and expected to continue until early 2006, with anticipated total costs exceeding $200 million.[68]

The Summitville Mine Site was first operated in the late 1870s and was most recently operated as a cyanide heap leach facility in the 1980s and early 1990s.[69] During the mine's historic operations (between 1890 and 1950), its shafts and tunnels often filled with groundwater, requiring the mine's operators to drill adits (horizontal openings intended to drain

60. *Id.*
61. *Manzo*, 182 F. Supp. 2d at 402-03.
62. *See Sunoco*, 337 F.3d at 1242.
63. *See id.* at 1235.
64. *Id.*
65. *Id.*
66. *See id.* at 1233.
67. *Id.* at 1236.
68. Appellant's Reply Brief at 1, Colorado v. Sunoco, Inc., 337 F.3d 1233 (10th Cir. 2003) (No. 02-1014).
69. Interim Record of Decision for Water Treatment at 4, Summitville Mine Superfund Site, Summitville, Colo. (on file with the United States Environmental Protection Agency, Region VII, Denver, Colo.).

water).[70] Following abandonment of the mine, highly contaminated, acidic water seeped from two main locations within the site: the Chandler adit and the Reynolds adit.[71]

A second source of contamination at the Summitville site was the heap-leach mining pad.[72] Heap-leach mining was a technique employed by the later-day operators of the mine, which entailed spraying a sodium cyanide solution over piles of crushed ore in efforts to extract gold.[73] After abandonment, snow and rainwater would leach through the piles of ore, and collect high amounts of residual cyanide and metals.[74] Due to a leaky and generally faulty water treatment system, the water, rich with cyanide and toxic metals, had accumulated into a million gallon holding pond on the site.[75] Periodically, the mine would experience releases of the cyanide and metal-rich water from the holding pond.[76] These releases caused numerous operational problems at the site and presented substantial danger to fisheries and ecosystems within the surrounding Alamosa River Watershed.[77]

In 1992, EPA, at the request of the State of Colorado, took emergency control of the Summitville site from the bankrupt operator and initiated a response plan, whereby the primary goal was treatment and containment of the millions of gallons of contaminated water until EPA could formulate a more permanent remedial plan.[78] The three actions of interest to the court in this case were "(1) the plugging of the Chandler adit; (2) the installation of monitoring wells in the Reynolds and Chandler adits; and (3) the construction of the sludge disposal area."[79] The first two actions commenced in 1994; the sludge disposal area was constructed sometime thereafter, and other long-term remedial actions began at the site in the spring and summer of 1995.[80] Colorado as well as the United States filed an initial cost-recovery suit in May 1996; however, that suit did not include the present defendants.[81] Instead, the State filed the suit against Sunoco in January 2001.[82] In the latter suit, the district

70. *Sunoco*, 337 F.3d at 1236.
71. *Id.* at 1236.
72. *Id.*
73. *Id.*
74. *Id.*
75. *Id.*
76. Colorado v. Sunoco, Inc., Civil Action No. 01-N-0001, at 2-3 (D. Colo. Sep. 14, 2001) (order and memorandum opinion).
77. *Sunoco*, 337 F.3d at 1237 n.1.
78. *Id.* at 1236-37.
79. *Id.* at 1237-38.
80. *Id.* Some sources indicate that construction began on the sludge disposal area sometime in 1994, while other sources suggest that it had not begun until April of 1995. *Id.* at 1238.
81. *Id.* at 1238.
82. *Id.*

court rejected Colorado's arguments,[83] and held that the governments had initiated construction of the three "remedial" actions prior to January of 1995, therefore rendering cost-recovery claims for those actions time-barred by CERCLA's statute of limitations.[84]

After entry of the District Court's judgment, Colorado filed a motion to reconsider, asserting the response action at the Summitville site could be separated into five operable units, each worthy of its own recovery action and thus, its own statute of limitations.[85] The district court rejected this argument on the merits and on grounds of timeliness, stating that Colorado had sufficient time to brief the issue in its response to Sunoco's motion for summary judgment.[86]

2. Decision

On appeal, the Tenth Circuit overturned the district court's holding on the grounds that it had not properly deferred to EPA characterizations made in the course of its response at the Summitville Mine Site, and it had inaccurately characterized EPA's actions at the site.[87] EPA and Colorado had argued before the Tenth Circuit that the three response actions in question at the Summitville site were "removal" actions and not "remedial" actions as the district court had found.[88]

This distinction had a direct impact upon the timeliness of the present claim because according to the district court's classification "the initiation of those ["remedial"] activities [would have] triggered the running of the [six year] statute of limitations under § 9613(g)(2)(B)," rendering the present cost recovery actions untimely.[89] However, if the actions at the site were deemed "removal" actions, as the agencies contended, the cost recovery claim would have been timely assuming scheduled "remedial" actions commenced as planned.[90] Under § 9613(g)(2)(b), when a subsequent "remedial" action commences within three years of a prior "removal" action, the statute of limitations for cost recovery on the second-stage "remedial" actions is extended.[91] The EPA was to commence construction of remedial actions at the Summitville site in the summer of 2004.[92] Therefore, when the EPA commences its planned "remedial" action at the Summitville site in the Summer of 2004, this action would fall within three years of the completion of the "removal"

83. *Id.* "Colorado asserted there were genuine issues of material fact concerning whether activities undertaken at the Site constituted removal or remedial actions and when physical on-site construction of a remedial action began at the Site." *Id.*

84. *Id.*

85. *Id.*

86. *Id.* at 1238-39.

87. *Id.* at 1243.

88. *See id.* at 1245.

89. *Id.* at 1243.

90. *Id.* at 1238.

91. 42 U.S.C. § 9613(g)(2)(B).

92. Mangone interview, *supra* note 57.

action at the site, and toll the statute of limitations for cost-recovery for another six years after the initiation of on-site construction of EPA's planned "remedial" action, according to 42 U.S.C. § 9613(g)(2)(B).[93] If Colorado could label the plugging of adits, the installation of monitoring wells, and construction of the sludge-disposal area as "removal" actions (and label the planned response action as "remedial"), it would then toll CERCLA's statute of limitations for six additional years, thus rendering the present cost-recovery action timely.[94]

The Tenth Circuit found that EPA's characterization of the three actions at the Summitville site were not worthy of *Chevron*-type deference, because it found "no indication that Congress intended for the EPA 'to speak with the force of law' in characterizing response actions for purposes of the application of CERCLA's statutes of limitation."[95] However, the Tenth Circuit did find the district court had erred in that such determinations by EPA were made in continuance of a congressionally assigned duty, and were worthy of *Skidmore*-type deference, which carries a weight on review not acknowledged by the district court.[96] The Tenth Circuit evaluated the plugging of the Chandler and Reynolds adits and the installation of the adit monitoring wells, concluding that those actions by the EPA constituted removal actions and not remedial actions as the district court had found.[97] Further, the Tenth Circuit found that genuine issues of material fact existed as to when the sludge disposal area was constructed.[98] Such a finding rendered a "removal" versus "remedial" determination irrelevant for this activity, and once again, the Tenth Circuit held that the district court erred in classifying that action as "remedial."[99]

A key, albeit collateral, argument made by Colorado in the case asserted that "cost recovery statutes of limitation in CERCLA were intended by Congress to apply separately to each individual removal and/or remedial action."[100] Colorado suggested several policy considerations to the Tenth Circuit that would underlie such a reading of the statute.[101] One of the most compelling arguments suggested by Colorado was its concern over the risk of mismanagement of government resources.[102] Colorado pointed out that in highly complex response actions, the cleanup of hazardous substances should be the primary focus of government resources, and therefore, the court should allow separable response actions

93. *See Sunoco*, 337 F.3d at 1241-42.
94. *Id.* at 1237; *see* 42 U.S.C. §§ 9613(g)(2)(A), (B).
95. *Sunoco*, 337 F.3d at 1243 (quoting *Mead Corp.*, 533 U.S. at 229).
96. *See id.* (citing *Skidmore*, 323 U.S. at 140).
97. *See id.* at 1243-44 (citing 42 U.S.C. § 9601(23)).
98. *Id.* at 1245.
99. *Id.* at 1245-46.
100. *Id.* at 1240.
101. *Id.* at 1240-41.
102. *Id.*

so that the government would be free from prematurely undergoing extensive investigations and the filing of speculative recovery actions against every PRP imaginable at an early juncture in the response period.[103] Furthermore, Colorado suggested that separating response actions into operable units "encourages at least partial government recovery of its cleanup costs from responsible parties, even if early time periods for recovery expire."[104]

Given the admonishment to the State that it did not raise the issue below, and having conceded that the issue of operable units may not have properly been before it, the Tenth Circuit chose to evaluate the issue nonetheless.[105] After acknowledging Colorado's policy arguments in favor of applying separate statutes of limitations to operable units, the court proceeded to a highly textual analysis of 42 U.S.C. § 9613(g)(2), finding that Congress's use of the articles "a" and "the" in the modification of the phrases "removal action" and "remedial action" obviated a congressional intention to render those actions whole and inseparable.[106] The court further affirmed this conclusion with an argument in equity, noting that 42 U.S.C. § 9613(g)(2)(A), (B) allows for the filing of subsequent actions to recover further costs, so long as the initial action is filed within the statutory period.[107] The Tenth Circuit, following this analysis, barred the application of CERCLA's statutes of limitation to separate operable units within a Superfund site.[108] Although the court's decision in regard to operable units may prove questionable, the Tenth Circuit's decision in *Sunoco* does leave potential for at least partial governmental cost recovery.[109] A favorable outcome remains possible if on remand Colorado can prove the actions were indeed removal actions, which were then followed by subsequent remedial actions within at least three years, tolling the statute of limitations according to 42 U.S.C. § 9613(g)(2)(B).[110]

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103. *See id.*
104. *Id.* at 1241.
105. *See id.*
106. *Id.*; 42 U.S.C. §§ 9613(g)(2)(A), (B).
107. *Sunoco*, 337 F.3d at 1241-42. However, this conclusion fails to address the very point that Colorado was asserting. That is, investigations following complex CERCLA response actions may uncover additional PRPs not contemplated at the initiation of the suit, or within the statutory time period. However, the court does point out that the defendants in this particular case were known at the filing of the initial action and the State simply failed to include those parties in the initial action. *Id.* at 1242 n.2.
108. *Id.* at 1240.
109. *See id.* at 1241-42.
110. *See id.*

E. Differing Analyses of the Operable Units Argument

1. *United States v. Manzo*[111]

a. Facts

The case of *United States v. Manzo* was a CERCLA cost-recovery action heard before the United States District Court for the District of New Jersey.[112] The defendants in that case acquired several lots of land that their predecessors had used as a landfill and as disposal areas for "waste oil, used filter clay, and [chemical] sludge."[113] After acquiring the land, the defendant leveled waste lagoons, spread waste over portions of the land parcels, mixed the waste with sand and gravel, and used some of this product to build a road through the land.[114] In 1979, EPA and the New Jersey Department of Environmental Protection ("NJDEP") (collectively "the Agencies"), discovered the presence of several hazardous substances at the site,[115] and entered into a cooperative agreement to use Superfund dollars for a response action.[116]

The Agencies initiated the response by dividing the remedial action into three operable units, each with a separate ROD.[117] At the time of the Agencies' filing of this suit, EPA had expended over $8 million in response costs at the Manzo's property, with additional costs expected in the future to undertake further response action.[118]

b. Decision

The court in *Manzo* first granted the United States' partial motion for summary judgment on grounds of liability for the response costs.[119] Next, the court addressed the Manzos' affirmative defense that the United States' claims were barred by CERCLA's statute of limitations.[120] The court acknowledged that little case law existed to guide it in applying "the statute of limitations provisions for cost recovery actions under CERCLA in the context of multiple RODs and operable units."[121] However, the court found that "[g]iven the prominent role of the concept of

111. 182 F. Supp. 2d 385 (D.N.J. 2000).

112. *Manzo*, 182 F. Supp. 2d at 388.

113. *Id.* at 389. The defendants also used portions of the land as a landfill until 1969, when a zoning injunction banned such a use. *Id.*

114. *Id.* at 390.

115. *Id.* At the Manzo's property, the EPA and NJDEP discovered various contaminants, including "polychlorinated bi-phenyls ("PCBs"), lead, methylene chloride, trichloroethylene, chloroform, and benzene . . . ." *Id.*

116. *Id.* at 391.

117. *Id.* at 391-92. The operable units were designated OU1, OU2, and OU3, each with a corresponding ROD, designated as ROD1, ROD2, and ROD3. *Id.*

118. *Id.* at 393. The $8 million figure included only the costs incurred through OU2 and OU3 response actions. *Id.*

119. *Id.* at 396.

120. *Id.* at 399.

121. *Id.*

operable units in the administrative framework governing the actual implementation of CERCLA, the Court cannot conclude that it is irrelevant for purposes of the statute of limitations whether EPA divided its task into different operable units."[122] Therefore, the court addressed the issue finding guidance in reasonable judicial presumptions, EPA's administrative framework, and policy considerations.[123]

The court in *Manzo* adhered to the general notion that in aims of at least partial government recovery of response costs, statutes of limitation should be construed liberally in the United States' favor.[124] The court recognized that the designation of operable units as part of EPA's response plan was vital to the effective cleanup of the site, and at least deserved some degree of deference.[125] In light of the policy concerns and practical advantages[126] of recognizing separate operable units and statutes of limitations, the court concluded that, "the statute of limitations does not bar compensation for [subsequent] operable units qualifying under the limitation even if the plaintiff is barred from seeking compensation for earlier operable units."[127] The court therefore denied Manzo's affirmative defense to bar cost recovery for OU2 and OU3, while the United States acknowledged that the statute of limitations had already barred cost recovery for OU1.[128]

2. *United States v. Azko Nobel Coatings, Inc.*[129]

United States v. Azko Nobel Coatings, Inc. was a cost recovery action against owners of a landfill in Lapeer County, Michigan.[130] Over the course of response activities on the site, EPA had issued two RODs, outlining two separate operable units within the response action.[131] In the cost recovery action, the defendants moved for summary judgment on grounds of CERCLA's statute of limitations.[132] However, the United States District Court for the Eastern District of Michigan, without extensive analysis of the issue, concluded that in following with United States Supreme Court precedent, statutes of limitation should be strictly construed "in favor of the Government where application of them might

122. *Id.* at 402.
123. *Id.* at 399.
124. *Id.* at 401.
125. *Id.*
126. *Id.* at 402-03 ("The United States asserts that, because of the complexity of Superfund sites, it is beneficial to divide response actions into different operable units and RODs because EPA is therefore able to move quickly to reduce health and environmental risks while continuing the process of studying other matters on the site.").
127. *Id.* at 402.
128. *Id.* at 403.
129. 990 F. Supp. 897 (E.D.Mich. 1998).
130. *Azko*, 990 F. Supp. at 899.
131. *Id.* at 902-03.
132. *Id.* at 900. EPA estimated at one point in the feasibility study that the response costs for OU1 alone would exceed $20 million. *Id.* at 902.

otherwise bar its rights."[133] Therefore, the *Azko* court separately applied CERCLA's statutes of limitation to the two operable units at the site, and further concluded that each response action fell within the allowable statutory period, thus dismissing the defendant's motion for summary judgment.[134]

3. *United States v. Ambroid Co.*[135]

In *United States v. Ambroid Co.*, the United States District Court for the District of Massachusetts found that CERCLA's statute of limitations barred an EPA cost-recovery action on grounds that the response action *must* be divided into separable units.[136] The court noted that most courts have interpreted "removal action" broadly so as to further the "essential purposes of CERCLA [which entails] cleaning up hazardous waste and doing so at the expense of those who created it."[137] Here, the United States tried to merge several phases of removal actions into one action, with hopes of tolling the statute of limitations upon the completion of the entire removal action.[138] However, the court begrudgingly held that contrary to the acknowledged underpinnings of CERCLA, the "broadest reasonable statutory interpretation . . . cannot save this case from its fate of partial summary judgment."[139] Interestingly, the court did not hesitate to separate ongoing response into distinct removal actions, and applied the statute of limitations to bar recovery for costs spent on the first "division."[140] The court divided the response action regardless of the fact that EPA had issued no official documentation (such as a ROD for a remedial action, or for removal actions, an Action Memorandum) for any removal actions undertaken at the site.[141] Such an unrestrained action suggests that the court in *Ambroid Co.* felt unhindered from freely separating multiple response actions within a site, and applying a separate statute of limitations to each.

II. ANALYSIS

It is apparent from the preceding cases that congressional intent, policy considerations, and practical concerns all have contributed to a broad statutory interpretation of CERCLA's statute of limitations. Courts' interpretation of CERCLA's statute of limitations has repeatedly allowed for governmental recapture of response costs in cases where the

133. *Id.* at 904; E.L. Du Pont de Nemours & Co. v. Davis, 264 U.S. 456 (1924)).
134. *Azko*, 990 F. Supp. at 903.
135. 34 F. Supp. 2d 86 (D.Mass. 1999).
136. *See Ambroid*, 34 F. Supp. 2d at 91.
137. *Id.* at 87 (citing Kelley v. E.I. DuPont De Nemours & Co., 17 F.3d 836, 843 (6th Cir. 1994)).
138. *See id.*
139. *Id.* at 90.
140. *See id.* at 89-90.
141. *See id.* RODs were not required because the site was not listed on the National Priorities List. *Id.* at 89.

PRP attempts to escape financial responsibility for its actions.[142] In addition, courts have generally deferred to EPA expertise in responding to releases at CERCLA sites, and as argued in this comment, they should continue to do so by giving EPA significant deference in characterizing response actions as removal or remedial, and by allowing EPA to apply separate statutes of limitations to operable units at a site.[143] Such deference allows for an orderly and phased approach to site cleanup without requiring the Agency to exhaust resources on liability investigations and legal proceedings at the expense of human health and the environment.

In the *Sunoco* decision, the Tenth Circuit rejected such an approach.[144] For the most part, the court sided with opponents to an expansive reading of CERCLA's statute of limitations who based their rationale upon a perceived congressional "intention that the government bring CERCLA suits in a prompt and timely manner,"[145] and upon a fear of unbridled and unlimited governmental recovery suits, potentially extending PRP liability indefinitely.[146] The opponents to multiple statutes of limitations argue that CERCLA's retroactivity may hold PRPs liable for actions taken decades in the past, and if left unbridled, liberally applied statutes of limitations may hold PRPs liable for decades into the future.[147] However, this concern merely amounts to a balancing of public interest.[148] Courts that have considered this balancing test have found that the "promotion of . . . [CERCLA's] goals outweighs the . . . argument that [broad] construction would permit the United States to extend the period of liability indefinitely . . . ."[149]

The Seventh Circuit Court of Appeals voiced its objection to a broad reading of CERCLA's statute of limitations in *United States v. Navistar International Transportation Corporation*.[150] The dispute in *Navistar*, like in *Sunoco*, centered on whether the cost recovery actions filed by the United States were time-barred by CERCLA's statute of limitations.[151] However, the court in *Navistar* focused its analysis upon whether the action filed constituted an "initial" cost recovery action, or a "subsequent" cost recovery action.[152] In *Navistar*, the Seventh Circuit rejected the United States' arguments that it should construe statutes of

142. *See generally* Czeschin, *supra* note 4, at 402.
143. *E.g.*, United States v. Manzo, 182 F. Supp. 2d 385, 401 (D.N.J. 2000).
144. Colorado v. Sunoco, Inc., 337 F.3d 1233, 1235 (10th Cir. 2003).
145. Czeschin, *supra* note 4, at 419.
146. *See* Garber, *supra* note 12, at 116.
147. *See generally* Czeschin, *supra* note 4, at 421 (construing United States v. Navistar Int'l Transp. Corp., 152 F.3d 702 (7th Cir. 1998)).
148. Czeschin, *supra* note 4, at 400.
149. *Manzo*, 182 F. Supp. 2d at 403.
150. 152 F.3d 702 (7th Cir. 1998).
151. *Navistar*, 152 F.3d at 705-06.
152. *Id.* at 706. In *Navistar*, if the court chose to label the suit before it a "subsequent action," it would have withstood the statute of limitations challenge. *Id.* The court instead labeled the action an "initial" one, and consequently barred the suit because the cost-recovery action was for a remedial action and had not commenced within six years of the initiation of on-site construction. *Id.*

limitations in the government's favor, and instead strictly interpreted CERCLA's statute of limitations as congressional recognition of a "need for filing of cost recovery actions in a timely fashion, to assure that evidence concerning liability and response costs is fresh . . . ."[153] The court in *Navistar* also asserted that "in order to achieve timely clean-up of affected sites and to ensure replenishment of the fund, cost recovery actions must commence in a timely fashion."[154]

The reasoning proffered by the court in *Navistar*, and implicitly followed by the Tenth Circuit in *Sunoco*, seems to accomplish little but to frustrate CERCLA cost-recovery actions. It appears ironic that in claimed efforts of ensuring replenishment of the fund, these courts did little but strengthen PRP defenses against the government in cost-recovery actions. These arguments also have the effect of placing government agencies and PRPs at risk of filing haphazard cost recovery suits in situations where evidence may be incomplete or undiscovered. Further, the approach taken by the *Navistar* and *Sunoco* courts may lead to rushed liability assignments, and may therefore bar cost-recovery claims against additional PRPs that government agencies have not yet been able to investigate or identify.

To refute the strict judicial interpretation of CERCLA's statute of limitations, opponents of the *Navistar* court's decision have submitted that "the negligence of public officers, who fail to act within the statutory period, should not prejudice the public interest the statute seeks to protect."[155] CERCLA was enacted primarily to protect human health and the environment, and secondly to ensure that the responsible parties, not the general public, are held financially accountable for cleaning up the pollution they caused.[156] In safeguarding these two concerns, Congress contemplated that several response actions may occur at a single site and thus intended courts to treat those response actions separately when challenged. [157] Such intent is apparent in the legislative history surrounding the enactment of CERCLA's statutes of limitation, in that Congress found the structure of CERCLA's statute of limitations "consistent with the overall structure of CERCLA, which contemplates that the President may bring a series of claims for response costs . . . with regard to a particular site . . . ."[158] Congress intended for courts to apply CERCLA's statutes of limitation separately to operable units because such application is consistent with typical deference lent to EPA characterizations made in the fulfillment of congressionally-assigned duties.[159] In addition,

153. *Id.* at 708 (quoting H.R. REP. NO. 99-253, pt. 1, at 138 (1985), *reprinted in* 1986 U.S.C.C.A.N. 3038, 3043).
154. *Id.* at 707.
155. Czeschin, *supra* note 4, at 410.
156. Garber, *supra* note 12, at 118.
157. *See* H.R. REP. NO. 99-962, at 221 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3276, 3314.
158. H.R. REP. NO. 99-962, at 223 (1986), *reprinted in* 1986 U.S.C.C.A.N. 3276, 3316.
159. *See generally Manzo*, 182 F. Supp. 2d at 402.

such application encourages expeditious cleanup of hazardous substances, and it rightly confers financial obligations for cleanup upon responsible parties.[160]

Undoubtedly, Colorado could have avoided the unfortunate decision of the Tenth Circuit in *Sunoco* had it filed the Sunoco action with the initial complaint in 1996, or in some intermediate time thereafter. As mentioned previously, Colorado knew of the current defendants at the filing of the initial action, and therefore if the State had joined Sunoco at that time it could have ensured at least partial recovery of costs accrued at the Summitville Mine Site. Moreover, if the State had properly set forth the operable units argument in its motion to deny summary judgment, the argument may have fared better with the Tenth Circuit on appeal. As it stood, the State set forth the operable units argument on a motion to reconsider and the Tenth Circuit proceeded to address the issue in its decision. If the issue was fully briefed and considered on its merits, the Tenth Circuit may have concluded differently, possibly finding persuasion from other jurisdictions' treatment of the operable units issue. As it stands, the decision in *Sunoco* may prove damaging for future cost-recovery claims arising from separate operable units of a response action.

The Tenth Circuit, by finding the district court's determinations of response actions inadequate, lent typical *Skidmore*-type deference to EPA characterizations of removal versus remedial actions, and remanded the case for further proceedings.[161] However, when considering EPA's determinations of CERCLA's statutes of limitation as applied to separate operable units, the Tenth Circuit found no need to extend *Chevron*-type deference or even *Skidmore*-type deference. In effect, the Tenth Circuit honored government agency decision-making in technical characterizations, but undercut the agencies as soon the time came to enforce those determinations in the manner that the agencies saw fit.

CONCLUSION

The Tenth Circuit decision in *Sunoco* will have an uncertain impact on future cases. In supposedly issuing a "wake-up call" to state and federal agencies to file timely and prompt cost-recovery actions, the Tenth Circuit may have overstepped its aims and in so doing, damaged future cost-recovery claims. The Tenth Circuit provided PRPs with a stronger affirmative defense than what Congress likely intended, and implicitly freed other potential PRPs from liability by mandating rushed or possibly incomplete agency investigations. On a different note, the decision may also harm PRPs in that the operable unit determination is advantageous to PRPs in their own cost-recovery or contribution actions, and the *Sunoco* decision impairs the enforceability of that characterization.

160. Czeschin, *supra* note 4, at 399-400.
161. *Sunoco*, 337 F.3d at 1243.

In the future, it is certain that legitimate CERCLA cost recovery actions will require an expansive reading of CERCLA's statute of limitations to ensure that all PRPs are discovered, and to guarantee that sufficient facts are known so that the agencies can competently prosecute them. Because of the Tenth Circuit's decision in *Sunoco*, government agencies may now have to divert resources away from site cleanup actions, and toward evidence collection and legal actions at early stages of the response. This decision circumvents Congress' intent to protect human health and the environment from hazardous substances at the expense of those profiting from the endangerment, and rewards them by allowing them to benefit from the fruits of their misfeasance. In so doing, the decision leaves the American public with the inherent dangers of hazardous substances while also requiring them to foot the bill for the cleanup.

Steve Rypma[*]

* J.D. Candidate, 2005, University of Denver College of Law. The author would like to thank Nancy Mangone for her guidance in researching and writing this comment.

RECONCILING PLEADING STANDARDS UNDER *PIRRAGLIA*: THE PRIVATE SECURITIES LITIGATION REFORM ACT V. FEDERAL RULE OF CIVIL PROCEDURE 12(B)(6)

INTRODUCTION

The Private Securities Litigation Reform Act ("PSLRA")[1] has been a source of turmoil since its introduction in 1995.[2] Congress adopted the PSLRA in hopes of reducing some of the abuse of securities litigation, specifically in the area of strike suits,[3] that had been steadily increasing in number up until the PSLRA's formation.[4] The statute was also enacted in response to "routine filing of lawsuits . . . whenever there is a significant change in an issuer's stock price, . . . abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle; . . . [and] manipulation by class action lawyers of the clients . . . ."[5] To discourage these suits, the PSLRA contained a heightened pleading standard that would make it tougher for a plaintiff to get a frivolous claim past a motion to dismiss action.[6]

This comment will focus specifically on a problem the circuit courts recently faced: 1) how to merge the heightened pleading standard under the PSLRA with the general pleading standard of Federal Rule of Civil Procedure 12(b)(6)[7], or 2) how to decide which will prevail when the two go to war with each other? Section I summarizes the history of the PSLRA and the current state of securities law within the circuit courts. Section II focuses on the current split in the circuit courts regarding the conflicting pleading standards under the lenient Rule 12(b)(6) and the strict PSLRA. Section III analyzes the most recent ruling on the topic by the Tenth Circuit in *Pirraglia v. Novell, Inc.*,[8] which is a case of first impression within the circuit. Section III then compares the Tenth Circuit's reasoning and outcome to other circuit courts that have ruled on the matter. Finally, Section IV reveals the author's conclusion on the

1. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C.).

2. Bruce Cannon Gibney, *The End of the Unbearable Lightness of Pleading: Scienter After Silicon Graphics*, 48 UCLA L. REV. 973, 975 (2001).

3. City of Philadelphia v. Fleming Cos., 264 F.3d 1245, 1258 (10th Cir. 2001) (discussing the enactment of the PSLRA). The court defined a strike suit as a: "'Shareholder derivative action begun with [the] hope of winning large attorney fees or private settlements, and with no intention of benefiting [the] corporation on behalf of which [the] suit is theoretically brought.'" *Fleming*, 264 F.3d at 1258 n.16 (quoting BLACK'S LAW DICTIONARY 1423 (6th ed. 1990)).

4. Gibney, *supra* note 2, at 975.

5. H.R. CONF. REP. NO. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 730.

6. *Fleming*, 264 F.3d at 1259 (citing H.R. CONF. REP. NO. 104-369, at 41 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 740).

7. FED. R. CIV. P. 12(b)(6).

8. 339 F.3d 1182 (10th Cir. 2003).

matter, specifically that the Tenth Circuit, through a fundamental departure from traditional motion to dismiss procedures, now applies a test that adequately reconciles the Rule 12(b)(6) and PSLRA pleading standards. This advances the legislative intent in enacting the PSLRA by providing protection to corporations from frivolous litigation, while simultaneously preserving a plaintiff's rights to survive a motion to dismiss when bringing a meritorious claim.

I. PSLRA BACKGROUND

A. Pre-PSLRA Securities Law

Prior to the PSLRA's introduction, confusion regarding the pleading standards for securities lawsuits had arisen among the circuit courts.[9] The Securities Act of 1933[10] and the Securities Exchange Act of 1934[11] governed securities law at the time.[12] In particular, Section 10(b) of the Exchange Act[13] and subsequent SEC Rule 10b-5[14] spoke to issues concerning fraud in the securities context.[15] Federal Rule of Civil Procedure 9(b),[16] which governs pleading requirements for fraud causes of action, had to be satisfied in order for plaintiffs to survive a motion to dismiss.[17] Rule 9(b) proscribes a heightened pleading standard where "the circumstances constituting fraud or mistake shall be stated with particularity."[18] Substantial debate arose among the circuit courts concerning the actual elements that must be proven to sustain a 10b-5 action, particularly as to whether scienter[19] was a mandatory element, or if negligent conduct alone would suffice.[20] In *Hochfelder*, the United States Supreme Court issued a response to the debate and, after a discussion concerning the plain language of the statute and the legislative intent, determined that the rule required a showing of scienter.[21] The Supreme Court stated that "[t]he words 'manipulative or deceptive' used in conjunction with 'de-

9. Gibney, *supra* note 2, at 979.

10. Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a -77aa (2000)).

11. Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78mm (2000)).

12. Jeffrey A. Berens, *Pleading Scienter Under the Private Securities Litigation Reform Act of 1995*, 31 COLO. LAW. 39, 39 (2002).

13. 15 U.S.C. § 78j(b).

14. 17 C.F.R. § 240.10b-5 (2003).

15. Scott H. Moss, *The Private Securities Litigation Reform Act: The Scienter Debacle*, 30 SETON HALL L. REV. 1279, 1279 (2000) (Section 10(b) and Rule 10b-5 "regulate[] and limit[] misrepresentations, omissions, and insider trading in securities.").

16. FED. R. CIV. P. 9(b).

17. Moss, *supra* note 15, at 1279.

18. FED. R. CIV. P. 9(b).

19. Scienter is defined as: "[A] mental state embracing [an] intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976).

20. *Hochfelder*, 425 U.S. at 197.

21. *Id.* at 201-02.

vice or contrivance' strongly suggest that 10(b) was intended to proscribe knowing or intentional misconduct."[22]

This ruling did not end the problems plaguing securities lawsuits, however. The actual pleading requirements alleging scienter that would suffice to survive a motion to dismiss were still in flux. Two extremes arose, one within the Ninth Circuit[23] and the other within the Second Circuit.[24] The Ninth Circuit had the most relaxed pleading requirements and did not require a plaintiff to allege any specific facts supporting scienter; a party only had to "aver scienter generally . . . simply by saying that scienter existed."[25] In contrast, the Second Circuit devised a test whereby the plaintiff must present facts sufficient to show a "strong inference" of scienter.[26] The "strong inference" could be demonstrated by a showing of actual knowledge; demonstrating that a defendant had the "motive to commit fraud and an opportunity to do so;"[27] or by presenting facts of "circumstantial evidence of either reckless or conscious behavior."[28] The Second and Ninth Circuit approaches differed significantly in the procedural requirements that a plaintiff must fulfill in order to survive a motion to dismiss. In response to this concern, among others, the legislature enacted the PSLRA to bring some consistency to securities law.[29]

B. The Congressional Response to the Securities Dilemma

In December of 1995 Congress passed the PSLRA in hopes of reducing "abusive class action securities fraud litigation," while still protecting investors and preserving investor confidence in the market.[30] To bring these hopes to fruition the PSLRA established a uniform pleading standard that requires a plaintiff involved in securities litigation to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[31] The pleading standard seems to contain the scienter element required by the Supreme Court in *Hochfelder* and also contains some of the same language used by the Second Circuit insofar as facts must be stated giving rise to a "strong inference."[32] Because the "strong inference" language was lifted from

22. *Id.* at 197.
23. *See In re* GlenFed, Inc. Sec. Litig., 42 F.3d 1541 (9th Cir. 1994).
24. *See In re* Time Warner, Inc. Sec. Litig., 9 F.3d 259 (2d Cir. 1993).
25. *GlenFed*, 42 F.3d at 1547.
26. *Time Warner*, 9 F.3d at 268.
27. *Id.* at 269. This test is commonly referred to as the Second Circuit's "motive and opportunity test." Berens, *supra* note 12, at 40.
28. *Time Warner*, 9 F.3d at 269.
29. Gibney, *supra* note 2, at 975.
30. Berens, *supra* note 12, at 40.
31. 15 U.S.C. § 78u-4(b)(2).
32. *See generally* Gibney, *supra* note 2, at 979 (The author notes that "Congress made no attempt to provide a more precise definition [of scienter] when enacting the PSLRA. . . . [However,] [t]he PSLRA raised the pleading bar through [the] strong inference standard, which is based in part on the Second Circuit test.").

Second Circuit precedents, debate arose among the circuit courts as to whether the PSLRA also codified the "motive and opportunity" test set forth by the Second Circuit as a means of establishing what constitutes a "strong inference."[33] Three separate views have emerged within the circuit courts and the Supreme Court has yet to address the issue.[34]

1. Alleging Motive and Opportunity Alone is Sufficient to Plead Scienter

Two circuit courts have concluded that a plaintiff need only allege motive and opportunity to survive a Rule 12(b)(6) motion. Not surprisingly, the Second Circuit adopted its own test as the correct means of establishing a "strong inference."[35] Likewise, the Third Circuit adopted the view that "it remains sufficient for plaintiffs [to] plead scienter by alleging facts 'establishing a motive and an opportunity to commit fraud, or by setting forth facts that constitute circumstantial evidence of either reckless or conscious behavior.'"[36]

2. Alleging Motive and Opportunity Alone is Never Sufficient to Plead Scienter

The Ninth Circuit recently determined that it would take an ironic step in the securities litigation arena. Once the bastion of the most lenient pleading standard among circuit courts in pre-PSLRA securities litigation, the Ninth Circuit has now established the most stringent and restrictive standard among the circuit courts. *In re Silicon Graphics Inc. Securities Litigation*[37] set the standard following the introduction of the PSLRA within the Ninth Circuit. The court made it clear that pleadings merely alleging motive and opportunity were insufficient to establish a "*strong* inference" that the defendant acted with the requisite intent.[38] Furthermore, the Ninth Circuit interpreted the PSLRA language that securities litigation plaintiffs must "state with particularity all facts" as requiring a plaintiff to "list . . . all relevant circumstances in great detail."[39]

3. Motive and Opportunity Can Provide Some Evidence of Scienter

The majority of the circuit courts that have passed judgment on the issue have adopted a middle ground approach to the "strong inference" standard.

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33. Moss, *supra* note 15, at 1282.

34. *See* Berens, *supra* note 12, at 39-40 (discussing the "tripartite split among the circuit courts").

35. *See* Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 537-39 (2d Cir. 1999) (The court held: "In this case, [Plaintiff] barely alleged motive and opportunity, but he nonetheless satisfied the pleading standards.").

36. *In re* Advanta Corp. Sec. Litig., 180 F.3d 525, 534-35 (3d Cir. 1999) (quoting Weiner v. Quaker Oats Co., 129 F.3d 310, 318 n.8 (3d Cir. 1997)).

37. 183 F.3d 970 (9th Cir. 1999).

38. *Silicon Graphics*, 183 F.3d at 974.

39. *Id.* at 983-84.

The Sixth Circuit espoused a view that pleadings of motive and opportunity are not enough to allege scienter under the PSLRA.[40] However, facts demonstrating motive and opportunity that also can provide some insight as to whether the defendant acted with the requisite mindset can establish a "strong inference" of scienter.[41] Therefore, the pleading of motive and opportunity could have some relevance in the "strong inference" analysis within the Sixth Circuit.[42]

In a short discussion in *Greebel v. FTP Software, Inc.*[43] the First Circuit adopted a similar stance to that of the Sixth Circuit.[44] There the court rejected the view that pleadings of motive and opportunity cannot be sufficient to demonstrate scienter.[45] The court warned, however, that only pleading motive and opportunity, without more, cannot rise to the level of a "strong inference" regardless of the strength of the motive and opportunity circumstances alleged.[46]

The Eleventh Circuit pointed to *Comshare* in holding what pleadings are sufficient to survive a motion to dismiss under the PSLRA.[47] The Eleventh Circuit "reject[ed] the notion that allegations of motive and opportunity to commit fraud, standing alone, are sufficient to establish scienter . . . ."[48] However, it sided with the Sixth and First Circuits in finding that evidence of motive and opportunity have some relevance in a motion to dismiss action under the PSLRA.[49]

4. The Tenth Circuit Takes a Side

In September 2001, the Tenth Circuit had its first occasion to review the PSLRA and the effect that it would have on securities litigation within the circuit. In *City of Philadelphia v. Fleming Cos.*,[50] the court had to decide what position to take on pleading scienter given the three-way split among the circuit courts in applying the PSLRA "strong inference" requirement.[51]

a. Facts

The plaintiffs were a certified class bringing a securities fraud action on the part of all people who held stock in Fleming Companies, Inc. ("Fleming") from the period of November 15, 1993 through March 14,

40. *In re* Comshare, Inc. Sec. Litig., 183 F.3d 542, 551 (6th Cir. 1999).
41. *Comshare*, 183 F.3d at 551.
42. *Id.*
43. 194 F.3d 185 (1st Cir. 1999).
44. *Greebel*, 194 F.3d at 197.
45. *Id.*
46. *Id.*
47. Bryant v. Avado Brands, Inc., 187 F.3d 1271, 1285 (11th Cir. 1999).
48. *Bryant*, 187 F.3d at 1285.
49. *Id.* at 1285-86.
50. 264 F.3d 1245 (10th Cir. 2001).
51. *Fleming*, 264 F.3d at 1248-49.

1996.[52] The defendants in the case consisted of Fleming, which is a large wholesale food distributor with stock listings on the New York, Midwest, and Pacific stock exchanges, and four Fleming corporate officers that signed documents alleged by plaintiffs to contain fraudulent information: Robert Stauth, R. Devening, Donald Eyler, and Kevin Twomey.[53] In 1989, Fleming entered into a "cost-plus" contract with David's Supermarkets, Inc. (David's) where Fleming would provide food and other products to David's at "Fleming's cost plus a fixed percentage over the actual cost . . . ."[54] In August 1993, David's filed suit against Fleming alleging that Fleming was overcharging David's by utilizing various discounts and incentives to overstate Fleming's costs in violation of the "cost-plus" contract, and alleging damages in an amended complaint of over $400 million.[55] In March 1996, the suit went to judgment and the jury awarded $200 million in damages plus costs to David's.[56] Fleming had not explicitly disclosed the existence of the suit until the judgment was awarded,[57] and as a result, shares of Fleming to dropped from $19.63 to $14.00 within days.[58] In May 1996, however, the verdict was set aside due to information regarding a conflict of interest between the trial judge and the plaintiffs.[59] Fleming settled the case for $19 million plus an undisclosed amount before a new trial was conducted.[60] The plaintiffs asserted that Fleming stock never recovered.[61]

In March 1996, after Fleming's disclosure of the lawsuit, nine separate class actions (consolidated for this case) were brought, alleging that the defendants did not disclose mandatory information regarding the David's litigation to the SEC or within Fleming's quarterly and annual stock reports.[62] The plaintiffs asserted that these omissions were "materially misleading" and in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.[63] The City of Philadelphia and Ronald Goldstein were named lead plaintiffs and a consolidated amended class action complaint was filed on April 30, 1997.[64] The district court dismissed the complaint ruling that scienter had not been pled appropriately under the PSLRA.[65] The district court pointed out that the "'[p]laintiffs simply [made] conclusory allegations that defendants were senior officers; therefore, they had actual knowledge or should have had

52. *Id.* at 1249.
53. *Id.* at 1249-50.
54. *Id.* at 1250.
55. *Id.* at 1250-51.
56. *Id.* at 1251-52.
57. *Id.* at 1253-54.
58. *Id.* at 1251-52.
59. *Id.* at 1252.
60. *Id.*
61. *Id.*
62. *Id.* at 1254.
63. *Id.*
64. *Id.*
65. *Id.*

actual knowledge of the 'true facts.'"[66] The court concluded that "[s]uch conclusory allegations of scienter are not sufficient under Rule 9(b), much less under the PSLRA."[67] The district court also rejected the plaintiffs' motive and opportunity arguments.[68] A second amended class action complaint was filed in April 1999 that contained an "Additional Scienter Allegations" section; this complaint reached the same fate as the original.[69] The plaintiffs also alleged five motives that may have enticed the defendants to conceal the litigation "despite their 'knowledge' that the litigation was material . . . ."[70] The dismissal of this complaint resulted in the *Fleming* appeal.[71]

b. Decision

The Tenth Circuit first engaged in a thorough discussion of securities pleading requirements in the circuit prior to the PSLRA, a discussion about the background and legislative formation of the PSLRA, and a discussion of how *Hochfelder* interpreted scienter in the securities context.[72] The court next went on to explain the three different approaches to scienter pleading adopted by the other circuit courts.[73] The Tenth Circuit opted to side with the First, Sixth, and Eleventh Circuits in finding a middle ground to apply to motive and opportunity.[74] It reasoned that because "[a]llegations of motive and opportunity, with nothing more, could allow potentially frivolous lawsuits to go forward with only minimal allegations of scienter," the congressional intent behind the PSLRA to "eliminate frivolous securities litigation through its heightened scienter pleading requirements" would be undermined.[75] The court went on to state, however, that motive and opportunity could be among the pieces that can be brought together to show the PSLRA "strong inference" requirement.[76] The Tenth Circuit opined that the entirety of the allegations must be considered without worrying about pigeon-holing certain facts into categories such as "motive" and "opportunity," and that a court

66. *Id.* at 1255.
67. *Id.*
68. *Id.*
69. *Id.*
70. *Id.* at 1256. The defendants' alleged motives were:
(1) to facilitate notes offerings on December 8, 1994; (2) to avoid jeopardizing the success of the FFMP [Fleming Flexible Marketing Plan]; (3) to minimize the possibility of future lawsuits alleging similar claims; (4) to "protect and enhance their executive positions and the substantial compensation and prestige they obtained thereby;" and (5) to enhance the value of their own Fleming stock.
Id. at 1256-57.
71. *Id.* at 1257.
72. *Id.* at 1257-59.
73. *Id.* at 1261.
74. *Id.*
75. *Id.* at 1263.
76. *Id.*

should only make a determination of whether a plaintiff's complaint gives rise to a "strong inference" when looked at as a whole.[77]

The court continued, upholding the district court's dismissal of the plaintiffs' action because the allegations pled did not rise to the level of a "strong inference" that the defendants acted with scienter.[78] The court first stated that the plaintiffs failed to provide particularized facts concerning why the court should infer that Devening and Twomey knew about the David's litigation or the materiality thereof.[79] Next, the court ruled that allegations directed at Stauth and Eyler were conclusory in nature, and that assuming merely because someone is a senior officer, they knew or should have known about certain aspects of the business, are "exactly the type of conclusory assertions of liability that the PSLRA was designed to prevent."[80] Next, the court pointed out that the plaintiffs failed to provide sufficient facts pertaining to why the David's litigation was material and therefore subject to mandatory disclosure.[81] In doing so, the court looked to the regulatory requirements for reporting pending lawsuits which state that only litigation involving greater than ten percent of current assets need be revealed.[82] Because the plaintiffs did not present any facts of Fleming's assets at the time of the litigation, the court could not rule on the materiality of the litigation and whether the existence of which should have been divulged.[83] Finally, the court reviewed all of the plaintiffs' motive arguments but found them to be unpersuasive.[84] None of the arguments, either by themselves or taken as a whole within the totality of the pleadings, gave rise to the "strong inference" that the defendants acted with scienter.[85] The motives the plaintiffs forwarded were motives shared by any corporation and its executives and were insufficient to impose liability on the defendants.[86]

II. THE PSLRA AND THE RULE 12(B)(6) PLEADING STANDARD: THE NEW CIRCUIT SPLIT EMERGES

In a Rule 12(b)(6) motion to dismiss, a court normally will view all facts and allegations as true and in the light most favorable to the non-moving party.[87] The reason for this is because, on a motion to dismiss, the court is not weighing any evidence but only testing the legal merit of

77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.* at 1264.
81. *Id.* at 1265.
82. *Id.* at 1266. (citing 17 C.F.R. § 229.103, Instruction 2 (2000)). The court determined that the ten-percent limit in 17 C.F.R. § 229.103, Instruction 2, established a "materiality threshold." *Id.*
83. *Id.*
84. *Id.* at 1269-70.
85. *Id.*
86. *Id.* at 1269 ("[G]eneralized motives shared by all companies and which are not specifically and uniquely related to Fleming in particular, are unavailing.").
87. Pirraglia v. Novell, Inc., 339 F.3d 1182, 1187 (10th Cir. 2003) (quoting Sutton v. Utah State Sch. for the Deaf & Blind, 173 F.3d 1226, 1236 (10th Cir. 1999)).

the plaintiff's claim to see if relief can be granted.[88] This results in leniency for the plaintiff at this stage. The PSLRA pleading standard is much more rigid, however, and cuts against the leniency of the 12(b)(6) standard by mandating that plaintiffs must "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, . . . [the plaintiff must] state with particularity all facts on which that belief is formed."[89] "[W]ith respect to each act or omission," the plaintiff must also "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."[90] The following section outlines how the circuit courts have dealt with the conflict between the PSLRA and 12(b)(6) pleading standards, and specifically looks at how the Tenth Circuit has merged the two standards in *Pirraglia*.

A. Circuit Courts Attempt to Reconcile the Conflicting Standards

1. First Circuit – *Aldridge v. A.T. Cross Corp.*[91]

The First Circuit takes the position that the pleading standards under Rule 12(b)(6) are unchanged by the PSLRA.[92] In *Aldridge*, on a motion to dismiss, the court made it clear it would continue to view all circumstances in the light most favorable to the plaintiffs.[93] The First Circuit did not render the PSLRA's stricter standards impotent, however, because the "strong inference" standard would still need to be shown by the plaintiffs in order to survive a motion to dismiss.[94] If, after looking at all of the plaintiff's pleadings in the best possible light, the plaintiffs had not pled with the specificity necessary to rise to the level of a "strong inference of scienter," then the motion to dismiss would be upheld.[95]

This view is the most relaxed pleading standard and provides plaintiffs with the best opportunity to survive a motion to dismiss. Other circuit courts have espoused views that have dramatically altered the face of 12(b)(6) hearings.

2. Sixth Circuit – *Helwig v. Vencor, Inc.*[96]

The Sixth Circuit takes the most restrictive view of pleading standards under the PSLRA at the 12(b)(6) stage.[97] While the First Circuit did not diverge from the established 12(b)(6) standard, the Sixth Circuit

88. *Pirraglia*, 339 F.3d at 1187 (quoting *Sutton*, 173 F.3d at, 1236).
89. 15 U.S.C. § 78u-4(b)(1).
90. *Id.* § 78u-4(b)(2).
91. 284 F.3d 72 (1st Cir. 2002).
92. *Aldridge*, 284 F.3d at 78.
93. *Id.*
94. *Id.*
95. *Id.*
96. 251 F.3d 540 (6th Cir. 2001).
97. *See Helwig*, 251 F.3d at 553-54.

made a plaintiff's task at the 12(b)(6) stage more difficult by allowing the defense to present their own ideas concerning the individual facts of a case for consideration by the court instead of just allowing the court to only view the plaintiff's allegations.

In *Helwig*, the court started off by declaring, "[o]ur willingness to draw inferences in favor of the plaintiff remains unchanged by the PSLRA."[98] The court then proceeded to justify this statement by looking to the policy behind the enactment of the PSLRA.[99] Congress did intend to heighten the pleading standard for security lawsuits, but the overriding purpose of protecting investors under the statute could not be served if the "strong inference" requirement prevented otherwise valid claims from proceeding through the judicial process.[100]

However, this line of reasoning did not prevent the court in finding a means to place some teeth in the PSLRA standard. The court followed with a discussion of how the "strong inference" standard did in fact change the 12(b)(6) pleading standard.[101] Instead of looking at all reasonable inferences, the court maintained that the plaintiff will only have the benefit of the "most plausible of competing inferences."[102] As support for the decision, the court discussed the meaning of "strong inferences" and ultimately concluded that the strength of the inference was attributable to the plausibility of concluding that the facts alleged by the plaintiff would point to some wrongful act committed by the defendant.[103]

This new pleading standard certainly diverges from the 12(b)(6) standard. It is unclear what the phrase "most plausible of competing inferences" refers to exactly.[104] Perhaps it is a balancing test, where the plaintiff's allegations are weighed against the defendant's and only if the plaintiff's argument is more "plausible" will the motion to dismiss under 12(b)(6) fail. If this is the case, then the Sixth Circuit certainly forwarded the legislature's intent of creating a heightened pleading standard. But how can the court also claim that it is avoiding a "choke-point for meritorious claims"[105] when all a defendant must do to eliminate legitimate litigation is to create a more logical, and therefore more "plausible", argument even when the plaintiff's allegations may still hold true?

One thing is clear from the Sixth Circuit holding. A securities plaintiff that wishes to survive a motion to dismiss in the Sixth Circuit must take extra care in compiling pre-motion pleadings to make sure that their

98. *Id.* at 553.
99. *Id.*
100. *Id.*
101. *Id.*
102. *Id.*
103. *Id.*
104. *Id.*
105. *Id.*

version of the facts will lead to an inference not only favorable to them, but also one that will be more plausible than any inferences that the defense might argue. The type of discovery that this type of pleading might require will most likely far surpass that which is normally sufficient at that stage of litigation. Consequently it could be argued that the Sixth Circuit's pleading standard will put plaintiffs in a disadvantaged position that would be at odds with the intent of the original Securities Acts of the 1930's. This strictest of standards is only currently adopted in the Sixth Circuit, however.

3. Eighth Circuit – *Kushner v. Beverly Enters., Inc.*[106]

Contrary to *Helwig*, the Eighth Circuit did not choose to adopt a pleading standard that would allow for the defense to introduce competing theories or inferences to those alleged by the plaintiff. The Eighth Circuit instead takes a position strikingly similar to that of the First Circuit, albeit under the guise of different terminology.

Whereas the First Circuit openly declared that the motion to dismiss pleading standards were unchanged by the PSLRA,[107] the Eighth Circuit stated "inferences . . . will not survive a motion to dismiss if they are only reasonable inferences-the inferences must be 'both reasonable and strong.'"[108] Because the "both reasonable and strong" terminology was taken from *Helwig*, it would seem that the Eighth Circuit adopted the Sixth Circuit pleading standard. This was not the case, however, because the Eighth Circuit openly denounced the Sixth Circuit's plausibility determinations at the 12(b)(6) stage of the proceedings in the earlier Eighth Circuit case of *In re K-tel International, Inc. Securities Litigation*.[109]

Why then is *Kushner* most similar to *Aldridge* when it seems that from the statements by the two courts they reach differing conclusions on the issue of pleading standards? The similarity comes from the functioning of the two standards when actually applied. While the First Circuit stated the 12(b)(6) standard was unchanged because it still took all allegations in the light most favorable to the plaintiff, the plaintiff was still required to meet the PSLRA "strong inference" standard in order for their case to survive.[110] This functions in the same way as the Eighth Circuit's "reasonable and strong" standard.[111] Under *Kushner*, a plaintiff in the Eighth Circuit will still have all reasonable inferences looked at in the light most favorable to him, but a reasonable inference is not enough

106. 317 F.3d 820 (8th Cir. 2003).
107. *Aldridge*, 284 F.3d at 78.
108. *Kushner*, 317 F.3d at 827 (quoting *Helwig*, 251 F.3d at 551).
109. 300 F.3d 881, 889 n.6 (8th Cir. 2002) ("[W]e do not believe that [the Eighth Circuit] adopted Helwig's statement about 'the most plausible of competing inferences' as the law of this Circuit.").
110. *Aldridge*, 284 F.3d at 78.
111. *Kushner*, 317 F.3d at 827.

to satisfy the pleading standard.[112] Like the First Circuit, an Eighth Circuit plaintiff must still allege facts that produce a "strong inference."[113] Therefore, for reasons other than semantics, the First and Eighth Circuits are in agreement over the proper pleading standard under the PSLRA.

4. Ninth Circuit – *Gompper v. VISX, Inc.*[114]

The Ninth Circuit has decided to take a middle of the road approach. While the pleading standard in the Ninth Circuit does not adopt the most plausible of competing inferences approach, and is consequently not as restrictive as the Sixth Circuit approach, the Ninth Circuit still will look at inferences promoted by the defense that are negative to the plaintiff's allegations.

After stating that it was the legislature's "crystal clear" intent that the heightened pleading standard under the PSLRA was to be the new pleading standard under a motion to dismiss, the Ninth Circuit proceeded to espouse a different pleading standard.[115] The usual assumption that all reasonable inferences would be examined was maintained; however, the phrase "in the light most favorable to the plaintiffs" was deleted and the new standard set in place that all reasonable inferences would in fact mean *all*.[116] From that point forward, whenever looking at a securities case, the court would also draw inferences against the plaintiff that could be used in the determination of whether the plaintiff's case survived the 12(b)(6) motion.[117] The Ninth Circuit then stated that both the reasonable positive inferences from the plaintiff's allegations and any reasonable negative inferences proposed by the defense must be contemplated as a whole and only then should a decision be made whether the plaintiff's pleadings meet the PSLRA pleading requirement for scienter.[118] This was not an exact adoption of the Sixth Circuit's most plausible of competing inferences standard, however, the Ninth Circuit acknowledged that it is impossible to determine whether allegations give rise to a strong inference when the plaintiff's allegations are evaluated in a vacuum.[119]

As an example of how this works, the plaintiffs in *Gompper* pled that the defendants engaged in numerous patent infringement suits against competitors because the defendants knew that their patents were invalid and wanted to intimidate the competitors.[120] The Ninth Circuit commented that this was a reasonable inference but also looked at the defendant's inference that the reason the defendants engaged in this liti-

112. *Id.*
113. *Id.*
114. 298 F.3d 893 (9th Cir. 2002).
115. *Gompper*, 298 F.3d at 897.
116. *Id.*
117. *Id.*
118. *Id.*
119. *Id.* at 896.
120. *Id.* at 896-97.

gation was because they felt the patents were valid and that the survival of the company rested on the successful litigation of patent infringement cases.[121] The court ruled that the defendants' negative inference cut against the plaintiffs' inference to a point that the plaintiffs were unable to have their allegation rise to the level of a strong inference.[122]

B. The Tenth Circuit's Stance in Pirraglia

The Tenth Circuit first addressed the issue of the PSLRA in 2001 while deciding *City of Philadelphia v. Fleming Cos.*[123] In *Fleming*, the court made the statement that at the 12(b)(6) stage of litigation the court looks at all allegations in the plaintiff's favor.[124] The court did not discuss, however, how the PSLRA pleading standard interacted with the 12(b)(6) standard. Therefore an initial viewing of Tenth Circuit precedent would seem to put it in line with the First Circuit, which also maintained that the motion to dismiss pleading standard was unchanged by the PSLRA.[125]

Curiously, however, in 2003 the Tenth Circuit decided *Pirraglia* and declared the issue of pleadings under both the PSLRA and Rule 12(b)(6) to be an issue of first impression within the circuit.[126] According to the court, *Fleming* did not touch on the precise issue to be decided in *Pirraglia*, which was to determine if, like the Ninth Circuit, the court should take into account reasonable inferences that are promoted by the defense and are negative to those pled by the plaintiffs.[127]

1. Facts

Pirraglia involved Novell, a computer software manufacturer/distributorship, along with some officers within the corporation as defendants and several investors who owned Novell stock as plaintiffs.[128] The plaintiffs accused Novell of violating securities laws by making materially false statements and producing faulty financial reports that resulted in losses for the investors when Novell stock prices dropped.[129] Subsequent to a stock price decrease following the release of the third quarter 1996 earnings report, Novell obtained a new Chairman and CEO, John Young, as well as a new President, former Vice President Joseph Marengi; both were pressured to increase Novell stock prices.[130] Novell's fourth quarter 1996 reported earnings exceeded earlier estimates and this

121. *Id.* at 897.
122. *Id.*
123. 264 F.3d 1245 (10th Cir. 2001).
124. *Fleming*, 264 F.3d at 1257.
125. *Aldridge*, 284 F.3d at 78.
126. *Pirraglia*, 339 F.3d at 1187.
127. *Id.*
128. *Id.* at 1184-85.
129. *Id.* at 1185-86.
130. *Id.* at 1185.

growth was attributed, per Novell, to increased demand for products that would continue through first quarter 1997.[131] First quarter 1997 actual earnings did not reflect this optimistic outlook, however, and the reported decline caused Novell shares to decrease from $13 to $10.[132] Young was subsequently fired and new Chairman and CEO, Eric Schmidt, was announced just prior to declaring second quarter 1997 earnings lower than projected, which in turn resulted in another price drop to $7.[133] The second quarter results yielded massive layoffs within Novell including the dismissal of Marengi, and Novell looked to reduce inventory in hopes of recovering.[134] The plaintiffs filed a class action naming Novell, Marengi, Young, and the CFO, Tolonen, as defendants.[135] Among the allegations were that 1) the defendants made fraudulent claims to investors that Novell had generally high demand for its products, 2) the defendants falsely stated that fourth quarter 1996 and first quarter 1997 strong financial reports were not based on special dealings with distributorships in an effort to reduce backlogged inventory, 3) that inventory remained in line with consumer needs, and finally 4) that defendants engaged in fraudulent accounting practices and inflated financial reports.[136]

2. Decision

The Tenth Circuit pointed out that there is no conceivable way to determine if an inference is a strong one without having other inferences to compare it to.[137] With this foundation, the court proceeded to accept the Ninth Circuit's view that inferences contrary to the plaintiff's position can indeed be drawn upon in an evaluative framework to determine what inference is strong in a given fact situation.[138] "[W]e consider the inference suggested by the plaintiff while acknowledging other possible inferences, and determine whether plaintiff's suggested inference is 'strong' in light of its overall context."[139]

The Tenth Circuit next distinguished its holding from the Sixth Circuit's holding and, like the Eighth and Ninth Circuits, did not accept the "most plausible of competing inferences" standard.[140] The role of the court in a motion to dismiss under the PSLRA is to determine the strength of the plaintiff's inference and not to weigh two or more competing inferences, a role better suited for the fact-finder.[141] The court continued to say that when faced by an inference favorable to the plain-

131. *Id.*
132. *Id.*
133. *Id.*
134. *Id.*
135. *Id.*
136. *Id.* at 1186.
137. *Id.* at 1187.
138. *Id.* at 1187-88.
139. *Id.* at 1187.
140. *Id.* at 1188 (quoting *Helwig*, 251 F.3d at 553).
141. *Id.*

tiff and one favorable to the defendant that seems to be equally strong, the court should not make a determination between the two; instead, the court should view the plaintiff's inference in the context of all reasonable inferences including the negative one to determine the overall strength of the plaintiff's inference.[142]

The Tenth Circuit then moved to the plaintiffs' case specifically to see if the district court's dismissal should be affirmed.[143] "[T]o satisfy the [PSLRA] pleading requirements, plaintiffs must (1) specify all allegedly misleading statements and the reasons why those statements are misleading, and (2) state with particularity facts giving rise to a strong inference that defendants made those statements with the requisite scienter."[144] The court looked individually at each of the four allegations presented by the plaintiffs and determined that the first three allegations were pled insufficiently under the PSLRA.[145] Pleadings were not pled with particularity as to allege fraudulent statements made by the defendants concerning positive demand for Novell products because the plaintiffs failed to provide any reasoning why the statements were misleading or that customer demand was so low that these statements might be misleading.[146] Furthermore, the court stated that even if the allegations were pled with sufficient particularity, these vague statements of confidence are not actionable under the PSLRA.[147]

Second, the court discussed the plaintiffs' allegations that the defendants made statements that Novell's favorable financial reports were not obtained through special deals and its supply remained in proportion to demand.[148] The court held that these allegations were not pled sufficiently because the PSLRA requires that where "'an allegation . . . is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed'" and the plaintiffs failed to provide these facts.[149] Because the plaintiffs' allegations were not based on first-hand knowledge of the statements made, but only on a good faith belief that they were true, the plaintiffs were required to plead facts giving rise to this belief.[150] They failed to do this.[151] Consequently, the district court's dismissal of these allegations was upheld by the circuit court.[152] Because the plaintiffs failed to plead the facts with the requisite

142. *Id.*
143. *Id.* at 1188-94.
144. *Id.* at 1188.
145. *Id.* at 1189-90.
146. *Id.* at 1189.
147. *Id.*
148. *Id.* at 1189-90.
149. *Id.* (quoting 15 U.S.C. § 78u-4(b)(1)).
150. *Id.*
151. *Id.* at 1190.
152. *Id.* at 1194.

specificity, the court had no need to evaluate them in light of the "strong inference" standard.[153]

The fourth allegation was a different matter, however. The plaintiffs' allegations that the defendants made fraudulent statements about Novell's accounting methods were pled with sufficient particularity and were sufficient to give rise to a "strong inference" that the defendants acted with scienter.[154] First, the court found that the allegedly false statements were clearly identified and the reasoning as to why they were misleading was adequately explained through proof in the form of statements made by Novell accountants that senior officers had reported unapproved revenue.[155] After the court made this determination it went on to assess the scienter portion of the pleading test.[156] The plaintiffs presented motive evidence that the defendants had special concern over the safety of their jobs, especially in light of the recent firings that Novell had undergone.[157] Further, the court cited evidence that the defendants had opportunity and control over public financial statements and could influence outsider decision making by altering them.[158] The court accepted these motive and opportunity allegations but again cautioned that motive and opportunity are not sufficient, in and of itself, to allege scienter in the Tenth Circuit.[159] Following *Fleming,* the court proceeded to review the totality of the pleadings to see if the motive and opportunity facts could help the plaintiffs allege scienter.[160]

In addition to motive and opportunity, the plaintiffs also alleged direct evidence of scienter in the form of defendants' violations of Generally Accepted Accounting Practices ("GAAP"), violations of internal corporate policies, and "damning" evidence of a revenue category listed on company spreadsheets entitled "In-transit."[161] Facts were supplied that the "In-transit" category was "fictitious sales of product that had not been sold. . . . to make up the short-fall between actual and targeted sales numbers."[162] The court noted that Rule 12(b)(6) required these allegations to be accepted as true and, as a result, the court determined that these facts, combined with the "motive and opportunity" allegations, were sufficient to establish a "strong inference" that the defendants acted with scienter when viewed in the totality of the pleadings.[163]

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153. *See id.* at 1190-91 (The court refused to review "allegations of scienter with respect to statements that fail to satisfy the first prong of the [PSLRA].").
154. *Id.* at 1190, 1192.
155. *Id.* at 1190.
156. *Id.*
157. *Id.* at 1191.
158. *Id.*
159. *Id.* (quoting *Fleming*, 264 F.3d at 1262).
160. *Id.*
161. *Id.* at 1192-93.
162. *Id.* at 1193.
163. *Id.*

The defendants presented a negative inference to be taken into account by the court; specifically, the "In-transit" allegations were absurd and not plausible.[164] The court determined that weighing the competing arguments was the duty of the fact-finder and that the plaintiffs' allegations rose to the level of a "strong inference" even in light of the defendants' argument.[165] The Tenth Circuit reversed the district court's judgment on the fourth allegation and remanded for further investigation.[166]

III. ANALYSIS

Before comparing the Tenth Circuit's decision to those of the other circuit courts, it is important to recall the reasoning behind the PSLRA. The heightened pleading standard was an attempt by Congress to provide some added protection to corporations from meritless securities suits.[167] The increase of securities based suits was only liable to increase in the future and the legislature perceived an eventual stranglehold on courts' time and resources.[168] The increased pleading standard demanding specificity in allegations, as well as requiring the allegations to rise to the level of a "strong inference" of wrongdoing on the part of the defendants, would hopefully weed out claims by investors who merely lost money in an uncertain stock market or who had no better evidence to base their claims of scienter on than general motives that would be common to any high level corporate officer.[169] On the other hand, it is important to realize that while the PSLRA was an answer to a growing dilemma caused by increased securities litigation, there are still many highly meritorious claims that deserve judicial attention. After all, the Securities Exchange Act of 1934, which is what the PSLRA hoped to reform in some but not all aspects, was enacted to protect investors from malfeasance at the hands of those who were in control and in a position to manipulate business actions for personal gain.[170] It is important that circuit courts balance these competing interests when deciding how to reconcile the 12(b)(6) and PSLRA pleading standards. If a court leans too far in the direction of the 12(b)(6) standard, then it is undermining exactly what the legislature hoped to accomplish by requiring the "strong inference" standard in the PSLRA and will allow a flood of strike-suits and other malicious litigation into the courts unchecked. Alternatively, were a court to give undue weight to the PSLRA, it may be foreclosing many truly injured parties from receiving the relief they deserve and allowing corporate controllers to get away with many of the same things that led to the

164. *Id.*
165. *Id.*
166. *Id.* at 1194.
167. *See* H.R. CONF. REP. NO. 104-369, at 41 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 740.
168. Gibney, *supra* note 2, at 975.
169. City of Philadelphia v. Fleming Cos., 264 F.3d 1245, 1258-59, 1263-64 (10th Cir. 2001).
170. Gibney, *supra* note 2, at 1012.

original 1934 legislation. With this foundation, the Tenth Circuit ruling can be reviewed in accordance with how well it balances these two countervailing policies.

Pirraglia contains a two-step analysis for the PSLRA pleading standard.[171] First, contrary to traditional pleading under 12(b)(6), inferences can be drawn against the plaintiff.[172] This is a radical step when taken within the context of our notion that the plaintiff's well-pled complaint is taken as true and construed in the light most favorable to the plaintiff in a motion to dismiss.[173] This is necessary, asserts the Tenth Circuit, because it is impossible to determine if a "strong inference" has been presented as mandated by the PSLRA unless there is some other inference or inferences to set it against for evaluation.[174] The strength of the plaintiff's inference can only be determined within the context of all reasonable inferences.

Although the court will look to negative inferences for purposes of evaluating the strength of the plaintiff's preferred inference, the second step to the analysis requires that the court not weigh multiple inferences in an attempt to decide which of them will ultimately constitute the prevailing argument.[175] According to the court, this would usurp the function of the fact-finder in the case and move beyond what a court is called to do at the 12(b)(6) stage.[176] Evidently, the court sees a difference between determining whether a plaintiff's inference is strong within the context of other reasonable, including negative, inferences that might be raised and "weighing" the plaintiff's inference against the other reasonable inferences.

The question still remains: did the Tenth Circuit's decision in *Pirraglia* fulfill the intent of the legislature when it enacted both the Securities Exchange Act of 1934 and the PSLRA while still giving credence to the lenient 12(b)(6) standard? The fact that, ultimately, the court will take the plaintiff's allegations as true does help injured investors find a forum for their grievance. Also, the fact that the plaintiff's inference must still establish the "strong inference" required under the PSLRA will discourage some frivolous claims. It will also ensure that others that do not have a legitimate claim will be effectively weeded out in a motion to dismiss when it is evident that they cannot indicate the alleged wrongful acts either with the requisite specificity or to the degree necessary to establish a "strong inference." But does the ability for the court to draw negative inferences go beyond the protection that even the legislature

171. Pirraglia v. Novell, Inc., 339 F.3d 1182, 1187-88 (10th Cir. 2003).
172. *Pirraglia*, 339 F.3d at 1187.
173. *Id.* (citing Sutton v. Utah State Sch. for the Deaf & Blind, 173 F.3d 1226, 1236 (10th Cir. 1999)).
174. *Id.* at 1188.
175. *Id.* (citing *Sutton*, 173 F.3d at 1236).
176. *Id.*

intended? It seems that maybe the First and Eighth Circuit's standards provide the best possible combination when trying to accommodate the competing policy concerns. Why not stop at allowing all allegations pled to be viewed in the light most favorable to the plaintiffs, but then still allow the claim to be dismissed if it seems that the pleading still is not adequate to rise to what the court believes is a "strong inference?" Perhaps the best answer can be found in the Tenth Circuit reasoning. It is not possible to determine what, in actuality, is a strong inference without having other inferences for comparison.[177] If the only inferences that could be looked at were those favorable to the plaintiff, it seems that a motion to dismiss could never succeed. Plaintiffs will only have to face the hurdle of whether or not their own inferences are reasonable. A district court faced with only being able to look at reasonable inferences that favor the plaintiff would never be able to find that an inference was not *strong* because there would be no other viewpoint to weigh it against.

The problem with this reasoning is that securities fraud suits rarely survive motions to dismiss, even in jurisdictions that claim the 12(b)(6) standard is unchanged by the PSLRA. Both *Kushner* and *Aldridge* are examples of cases from the most lenient circuit courts that still resulted in strong-inference requirements for at least some allegations not being met. The Tenth Circuit's new pleading standard that allows negative inferences to be taken into account only makes a plaintiff's chances of surviving a 12(b)(6) motion more remote than they already were. This must raise concerns about the PSLRA too tightly constricting the chances of meritorious securities fraud claims surviving until litigation. Does this mean the Tenth Circuit, as well as others like the Ninth and the strict Sixth have gone beyond the intent of the legislature and made it impossible for a plaintiff to successfully bring claims? The answer to this question must be a resounding no. Although it will be difficult for plaintiffs at the 12(b)(6) stage to prove the requisite strong inference standard, *Pirraglia* itself is an example when plaintiffs pled sufficient facts to overcome a defendant's negative inference and survived the motion to dismiss. It would be difficult to argue that the circuit courts have made the pleading standard too high to overcome when plaintiffs in the stricter Tenth Circuit were able to successfully plead scienter.

Ergo, although the Tenth and Ninth Circuits may seem to be radical departures from the common 12(b)(6) pleading standard and make a plaintiff's task at a motion to dismiss hearing even more trying than was previously the case, they are also the decisions that make the most sense in the context of legislative intent for the Securities Act of 1934, the PSLRA, and Rule 12(b)(6). The decisions also succeed in both protecting investors and eliminating frivolous securities litigation practices. Ultimately they are the only circuit courts that have reconciled the 12(b)(6)

177. *Id.* at 1187.

and PSLRA pleading standards without rendering one or the other void of all meaning.

CONCLUSION

Although it may seem that the circuit courts' differing views on how the Rule 12(b)(6) and PSLRA pleadings standards should be reconciled may not differ greatly, it is important to realize how radical the Tenth, Ninth and Sixth Circuits' departure from the traditional Rule 12(b)(6) standard is. No longer will securities litigation plaintiffs in these jurisdictions have the benefit of their well-pled complaints looked at in the light most favorable to them. While their facts must still be accepted as true at the 12(b)(6) stage, the ability for courts to draw inferences against plaintiffs based on the facts alleged is a monumental exodus from the idea that we should provide leniency to plaintiffs at this point in litigation. That said, the Tenth Circuit ruling in *Pirraglia* has appropriately advanced the legislature's intent when it enacted the PSLRA, while simultaneously preserving much of the leniency inherent in the traditional Rule 12(b)(6) standard.

As the plaintiffs in *Pirraglia* found, a negative inference that has been drawn against their facts can still be overcome as long as particular facts are alleged that do rise to the level of a "strong inference" when viewed in the totality of the pleadings.[178] In *Pirraglia* the Tenth Circuit provided a legal test that protects both a corporation from frivolous and malicious litigation, as well as corporate stockholders from abuse by senior officers in a position to manipulate securities for their own gain.

It is important to keep in mind, however, that this balance is still skewed towards making it tough on plaintiffs to bring claims that will survive until litigation. The PSLRA was a reaction to the growing numbers of frivolous suits and provided protection primarily to corporations.[179] On the heels of debacles like Enron and Worldcom, maybe it is time for the legislature to once again rethink what pleading standards are in the public's best interest.

Although the public policy behind the PSLRA is admirable and saves companies considerable amounts of money by helping them to avoid frivolous suits, maybe a public policy stance that protects investors and allows them a road devoid of obstacles that plaintiffs in other types of litigation do not have to overcome would actually benefit the public more. In the end, the reconciliation of the PSLRA and the Rule 12(b)(6) standard is important in the context of current law. But ultimately, a re-

178. *Id.*
179. H.R. CONF. REP. NO. 104-369, at 41 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 740.

structuring of securities law as a whole may be more beneficial than trying to mold pleading standards.

Rick M. Simmons[*]

* J.D. Candidate, 2005, University of Denver College of Law.

REMMER'S PRESUMPTION OF PREJUDICE: THE TENTH CIRCUIT'S POSITION

INTRODUCTION

The Sixth Amendment to the United States Constitution guarantees all criminal defendants the right to "a speedy and public trial, by an impartial jury . . . ."[1] Extraneous information that has a prejudicial effect on a jury's verdict denies criminally accused individuals this guarantee and, as such, is inimical to our adversarial system of justice.[2]

For over a century the United States Supreme Court has recognized that any private communications with the jury about the case pending before them, other than the presentations of the parties and the court's instructions, are "absolutely forbidden, and invalidate the verdict . . . unless their harmlessness is made to appear."[3] Because outside contact with the jury, regardless of whether or not it was intentional, risks the jury basing its decision on something other than the record and applicable law, proof of such contacts results in the *Remmer* presumption of prejudice.[4] The *Remmer* presumption is not conclusive, but does require the party defending the verdict to establish that the contacts did not, in fact, prejudice the jury.[5]

In recent years, however, several federal circuits have either significantly narrowed the *Remmer* presumption, or held that it has been abandoned altogether. While the First, Seventh, Tenth, and Eleventh Circuits maintain that the *Remmer* presumption must be applied in every case involving evidence of an external influence on the jury,[6] the Sixth Circuit has concluded that the presumption no longer applies at all.[7] Most other circuits have taken a middle ground, reading subsequent Supreme Court decisions to retreat from or reconfigure the *Remmer* presumption in various and conflicting ways.[8] Nevertheless, whether the *Remmer* presump-

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1. U.S. CONST. amend. VI.

2. *See* Turner v. Louisiana, 379 U.S. 466, 472-74 (1965); *see also* Remmer v. United States, 347 U.S. 227, 229 (1954).

3. Mattox v. United States, 146 U.S. 140, 150 (1892).

4. *See Remmer*, 347 U.S. at 229.

5. *Id.*

6. *See* United States v. Scull, 321 F.3d 1270, 1280 (10th Cir. 2003); Schaff v. Snyder, 190 F.3d 513, 533-34 (7th Cir. 1999); United States v. Martinez, 14 F.3d 543, 550 (11th Cir. 1994); United States v. O'Brien, 972 F.2d 12, 14 (1st Cir. 1992).

7. United States v. Pennell, 737 F.2d 521, 532-33 (6th Cir. 1984).

8. *See* United States v. Sylvester, 143 F.3d 923, 933-34 (5th Cir. 1998) (arguing *Remmer* standard was reconfigured by *Smith v. Phillips*, 455 U.S. 209 (1982) and *United States v. Olano*, 507 U.S. 725 (1993)); United States v. Williams-Davis, 90 F.3d 490, 496 (D.C. Cir. 1996) (questioning the appropriate breadth of *Remmer* and suggesting that the District of Columbia Circuit no longer treats the presumption as "particularly forceful"); Stephens v. S. Atl. Canners, Inc., 848 F.2d 484, 485-89 (4th Cir. 1988) (quoting Haley v. Blue Ridge Transfer Co., 802 F.2d 1532, 1537 n.9 (4th Cir.

tion applies, and in what form, is a question with serious implications, and the split in the circuits undoubtedly means the outcomes in like cases will vary depending upon the circuit in which they arise.[9]

Part I of this survey reviews the Supreme Court's relevant precedents. Part II of this survey then reviews several cases from the Tenth Circuit, examining how the Tenth Circuit interprets and applies the *Remmer* presumption. Finally, Part III of this survey suggests that, while the enactment of Federal Rule of Evidence 606(b) and subsequent Supreme Court decisions in *Smith v. Phillips*[10] and *United States v. Olano*[11] may have limited its application, the *Remmer* presumption remains good law. Moreover, were the Supreme Court to exercise its certiorari jurisdiction in order to settle the split in the federal circuits over this question, it would likely uphold the *Remmer* presumption's validity as a necessary safeguard for the protection of our constitutional right to a fair trial by an impartial jury.

I. BACKGROUND

The Supreme Court first squarely addressed the problem of improper extraneous influences in *Mattox v. United States*.[12] In *Mattox*, the bailiff discussed the case with the jury, conveying information not presented at trial regarding the defendant's past criminal record.[13] In addition, a newspaper article that contained details of the trial and the strength of the government's case against the defendant was left in the jury room.[14] Nevertheless, the trial court refused to consider juror affidavits describing these facts on the ground that juror testimony could not be used to impeach a verdict, and denied the defendant's motion for a new trial.[15]

The Supreme Court reversed, holding that while jurors may not testify as to their particular state of mind or reasons for reaching the verdict, they may "testify to any facts bearing upon the question of the existence of any extraneous influence . . . ."[16] Furthermore, the court declared that "[p]rivate communications, possibly prejudicial, between jurors and third persons, or witnesses, or the officer in charge, are absolutely forbidden, and invalidate the verdict . . . unless their harmlessness is made to ap-

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1986) (modifying the *Remmer* presumption and applying it only to cases in which the party challenging the verdict makes a threshold showing that the *ex parte* contact was "more than innocuous").

9. *See* Petition for Writ of Certiorari at 17, Exxon Mobile Corp. v. Baker, 531 U.S. 919 (2000) (No. 00-90).

10. 455 U.S. 209 (1982).

11. 507 U.S. 725 (1993).

12. 146 U.S. 140 (1892).

13. *Mattox*, 146 U.S. at 142.

14. *Id.* at 142-44.

15. *Id.* at 141, 144.

16. *Id.* at 148-49.

pear."[17] Thus, the affidavits in question were "material" evidence of prejudice and, accordingly, their exclusion constituted reversible error.[18]

A half a century later, in *Remmer v. United States*,[19] the Supreme Court set out the procedure the trial court should follow when unauthorized contact with jurors occurs.[20] In *Remmer*, after the jury had returned its verdict, the petitioner learned for the first time that during the trial an unnamed person commented to a member of the jury, later the jury foreman, that he could profit by delivering a verdict favorable to the petitioner.[21] "The juror reported the incident to the judge, who informed the prosecuting attorneys . . . ."[22] An investigation took place.[23] Based on its report, the judge and the prosecutors concluded the statement to the juror was made in jest and took no further action.[24] However, the court failed to inform the petitioner of the incident before the verdict, and he learned of the matter only after reading about it in the newspapers.[25]

The Supreme Court held that "any private communication, contact, or tampering directly or indirectly, with a juror during a trial about the matter pending before the jury is, for obvious reasons, deemed presumptively prejudicial, if not made in pursuance of known rules of the court . . . ."[26] Although the presumption of prejudice is not conclusive, the prosecution bears the heavy burden of proving that such communication, contact, or tampering constitutes harmless error.[27] Furthermore, a trial court should not make decisions *ex parte*, but rather should "determine the circumstances, the impact thereof upon the juror, and whether or not it was prejudicial, in a hearing with all interested parties permitted to participate."[28]

The Supreme Court decided *Remmer* prior to the enactment of Federal Rule of Evidence 606(b). Rule 606(b) sets the boundaries for authorized intrusions into the province of the jury.[29] In particular, the Rule prohibits a juror from testifying about his mental processes in reaching a verdict.[30] A juror may, however, testify as to "whether extraneous prejudicial information was improperly brought to the jury's attention or whether any outside influence was improperly brought to bear upon any

17. *Id.* at 150.
18. *Id.* at 149.
19. 347 U.S. 227 (1954).
20. *Remmer*, 347 U.S. at 229-30.
21. *Id.* at 228.
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.* at 229.
27. *Id.*
28. *Id.* at 229-30.
29. *See* FED. R. EVID. 606(b).
30. *Id.*

juror."[31] As such, Rule 606(b) "allows testimony about the fact and nature of the contact . . . but not about the effect it produced on the juror's state of mind."[32]

The Supreme Court considered the application of Rule 606(b) in *Tanner v. United States*.[33] In *Tanner*, the defendant sought a new trial because, after his conviction, Tanner's attorney received a telephone call from one of the jurors informing him that several of the jurors drank alcohol during their lunch breaks and slept through the afternoons.[34] After the district court denied the motion for a new trial, and while the case was on appeal, Tanner's attorney received another call from a different juror, who informed him that he and three other members of the jury had smoked marijuana regularly during the trial.[35] Furthermore, the juror observed at least two other members of the jury ingest cocaine during the trial; one in particular "described himself . . . as 'flying.'"[36]

The Court held that it was not error for the district court to refuse to conduct an evidentiary hearing that would have included juror testimony because Rule 606(b) barred juror testimony regarding drug and alcohol use by jurors during trial.[37] Rule 606(b), the Court stated, was grounded in the long-standing common law rule that prohibited jury testimony to impeach a verdict once delivered by the jury, unless in regard to any "'extraneous influence'" which may have affected the jury's deliberations.[38] The rule was meant to shield the jury's deliberation from public scrutiny so that what was intended to be a private deliberation did not become the "subject of public investigation--to the destruction of all frankness and freedom of discussion and conference," and the integrity of the judicial system.[39]

In *Smith v. Phillips*,[40] the Supreme Court first called into question the issue of whether bias may be inferred where there is a question about whether some factor other than the evidence presented in the particular case has affected the juror's ability to remain impartial.[41] In *Phillips*, the United States District Court for the Southern District of New York and the Second Circuit Court of Appeals concluded that a *habeas* petitioner was entitled to a new trial based on the alleged partiality of a juror who

31. *Id.*
32. United States v. Williams-Davis, 90 F.3d 490, 496 (D.C. Cir. 1996); *see* Tanner v. United States, 483 U.S. 107, 116-27 (1987) (explaining the origins of and rationale behind the rule).
33. 483 U.S. 107 (1987).
34. *Tanner*, 483 U.S. at 113.
35. *Id.* at 115.
36. *Id.* at 115-16.
37. *Id.* at 125.
38. *Id.* at 117 (quoting *Mattox*, 146 U.S. at 149).
39. *Id.* at 119-20 (quoting McDonald v. Pless, 238 U.S. 264, 268 (1915)).
40. 455 U.S. 209 (1982).
41. *Phillips*, 455 U.S. at 215-17.

previously applied for a job in the prosecutor's office.[42] Although the trial court conducted a hearing and determined the juror was not prejudiced, the federal courts concluded that the trial court should have conclusively presumed prejudice given the facts.[43]

The Supreme Court, citing *Remmer*, reversed, holding that due process requires only that the trial court hold a hearing to determine the existence of prejudice.[44] The court thought it was improper to presume prejudice because the pre-trial *voir dire* and the post-trial hearing were sufficient to protect the defendant's rights.[45] Furthermore, the Court concluded "[t]his Court has long held that the remedy for allegations of juror partiality is a hearing in which the *defendant* has the opportunity to prove actual bias."[46] Some have read this particular statement as a retreat from the *Remmer* presumption because if a presumption of prejudice existed, the defendant would not need an opportunity to prove the jury was biased.[47]

The Supreme Court again shed doubt on the *Remmer* presumption in *United States v. Olano*.[48] There, the defendants were convicted in the United States District Court for the Western District of Washington on charges relating to a loan kickback scheme.[49] On appeal, the defendants contended it was plain error for the trial court to allow alternate jurors to sit with the jury during deliberations, despite being told not to participate.[50]

After the Ninth Circuit Court of Appeals vacated the defendant's convictions,[51] the Supreme Court reversed concluding that because the conceded error did not effect substantial rights, the Appeals Court was without authority to correct it.[52] Moreover, in discussing what it called "intrusion jurisprudence," the Court stated "[t]here may be cases where an intrusion should be presumed prejudicial, but a presumption of prejudice as opposed to a specific analysis does not change the ultimate inquiry: Did the intrusion affect the jury's deliberations and thereby its verdict?"[53]

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42. *Id.* at 214.
43. *Id.*
44. *Id.* at 217.
45. *Id.*
46. *Id.* at 215 (emphasis added).
47. *See Williams-Davis*, 90 F.3d at 496; *see also* United States v. Sylvester, 143 F.3d 923, 934 (5th Cir. 1998).
48. 507 U.S. 725 (1993).
49. *Olano*, 507 U.S. at 727.
50. *Id.*
51. *Id.* at 731.
52. *Id.* at 741.
53. *Id.* at 738-39 (citations omitted).

II. UNITED STATES COURTS OF APPEALS DECISIONS

A. The Tenth Circuit

The Tenth Circuit, without qualification, follows the principles first established in *Mattox* and *Remmer*.[54] In *Mayhue v. St. Francis Hosp. of Wichita, Inc.*,[55] the court declared that "[t]he law in the Tenth Circuit is clear. A rebuttable presumption of prejudice arises whenever a jury is exposed to external information in contravention of a district court's instructions."[56] While acknowledging the split in the circuits over the validity and applicability of the *Remmer* presumption, in its most recent decision, the Tenth Circuit shows no sign of retreating from this position.[57]

1. *United States v. Greer*[58]

a. Facts

In *Greer,* the defendant was convicted in the United States District Court for the Northern District of Oklahoma of drug violations.[59] On appeal, the defendant alleged improper contact between a United States Deputy Marshal and the jury prejudiced him.[60]

At a lunch break during trial, the Marshal presented information to the jury concerning possible sentencing under the Federal Youth Corrections Act.[61] The allegedly improper contact came to the trial court's attention after the verdict was entered and the defendant was sentenced.[62] Following a hearing, the trial court held that the contact was not prejudicial.[63]

b. Decision

The Tenth Circuit, citing *Remmer*, held that "[a]ny private contact with jurors during trial about the matter pending before them is 'presumptively prejudicial.'"[64] Moreover, "[i]f a guilty verdict following prejudicial contact is to be sustained, the government must 'establish . . . that such contact with the juror was harmless to the defendant.'"[65] The

54. *See* United States v. Scull, 321 F.3d 1270, 1280 (10th Cir. 2003); Mayhue v. St. Francis Hosp. of Wichita, Inc., 969 F.2d 919, 922 (10th Cir. 1992); United States v. Hornung, 848 F.2d 1040, 1044-45 (10th Cir. 1988).
55. 969 F.2d 919 (10th Cir. 1992).
56. *Mayhue*, 969 F.2d at 922.
57. *Scull*, 321 F.3d at 1280 n.5.
58. 620 F.2d 1383 (10th Cir. 1980).
59. *Greer*, 620 F.2d at 1384.
60. *Id.*
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.* at 1385 (quoting Remmer v. United States, 347 U.S. 227, 229 (1954)).
65. *Id.* (quoting *Remmer*, 347 U.S. at 229).

court concluded, however, that Federal Rule of Evidence 606(b) radically modified *Remmer's* requirement that the trial court "'determine the circumstances (of the contact), the impact thereof upon the juror, and whether or not it was prejudicial.'"[66]

"Under Rule 606(b), an inquiry into a verdict is limited to a determination 'whether extraneous prejudicial information was improperly brought to the jury's attention or whether any outside influence was improperly brought to bear upon any juror.'"[67] Courts can, thus, no longer inquire into the effect of extraneous information or outside influence upon a juror's "'mind or emotions as influencing him to assent to or dissent from the verdict.'"[68] As a result of this, the court concluded, "a presumption of prejudice cannot be overcome once a jury has reached its verdict."[69] Accordingly, the court suggested that Rule 606(b) "may require the courts to narrow [*Remmer's*] definition of 'presumptively prejudicial' . . . ."[70]

2. *United States v. Hornung*[71]

a. Facts

In *Hornung*, the Tenth Circuit applied the *Remmer* presumption in upholding a jury verdict despite improper contact between a juror and a bank teller.[72] In *Hornung*, the United States District Court for the Western District of Oklahoma convicted the defendant of conspiring to defraud the United States by concealing taxable income.[73] On appeal, the defendant contended that the trial court should have granted his motion for a new trial because of an improper third-party contact with a juror.[74]

While a juror was conducting routine business at his bank, a teller informed him of the defendant's illicit activities at the bank.[75] The teller mentioned she was familiar with the defendant because he had come into the bank with another man and attempted to launder $6,000.00.[76] The juror indicated in his affidavit that the information imparted by the teller in the course of their brief conversation was unsolicited and that he had discussed the conversation with another juror.[77]

66. *Id.* (quoting *Remmer*, 347 U.S. at 330).
67. *Id.* (quoting FED. R. EVID. 606(b)).
68. *Id.* (quoting FED. R. EVID. 606(b)).
69. *Id.*
70. *Id.* at 1385 n.1 (quoting *Remmer*, 347 U.S. at 229).
71. 848 F.2d 1040 (10th Cir. 1988).
72. *Hornung*, 848 F.2d at 1044.
73. *Id.* at 1042.
74. *Id.* at 1043.
75. *Id.*
76. *Id.*
77. *Id.* at 1043-44.

The trial court conducted a hearing to determine whether possible juror misconduct had occurred and, if so, whether it was prejudicial to the defendant.[78] Upon the completion of the hearing, the court denied the defendant's motion for a new trial.[79]

b. Decision

In the course of discussing the juror's exposure to extrinsic influences, the Tenth Circuit stated that the trial court has broad discretion in reviewing the possible effect of extraneous information upon the jury's verdict.[80] Moreover, contrary to what the defendant argued, *Greer* does not stand for the proposition that the *Remmer* presumption is irrebuttable.[81] Rather, the majority of the court simply rejected the application of a conclusive presumption, and maintained the presumption can be overcome by showing the contact with the juror was harmless.[82] In *Hornung*, while the court deemed the communication to be "about the matter before the jury," and would be treated as "presumptively prejudicial," it concluded "the presumption was rebutted by the overwhelming evidence of the defendant's guilt."[83] Accordingly, the district court did not err by denying the defendant's motion for a new trial.[84]

3. *United States v. Scull*[85]

a. Facts

Recently, in *Scull*, the Tenth circuit again upheld the validity of the *Remmer* presumption.[86] Following a jury trial, the United States District Court for the District of New Mexico convicted Gus Bono of a "variety of counts relating to manufacturing, possessing, and distributing crack cocaine, and conspiracy to commit the same."[87] On appeal, the defendant maintained his case should have been remanded for a new trial because the district court erred by denying him his Sixth Amendment right to a fair and impartial jury.[88] In particular, the defendant argued the court mishandled his allegation of juror taint and prejudice.[89]

On the second day of trial, an alternate member of the jury informed the court that he believed he observed the defendant's counsel speaking

78. *Id.* at 1044.
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.* at 1044-45.
83. *Id.* at 1044 (internal quotations omitted).
84. *Id.* at 1046.
85. 321 F.3d 1270 (10th Cir. 2003).
86. *Scull*, 321 F.3d at 1280 n.5.
87. *Id.* at 1274.
88. *Id.*
89. *Id.*

with another jury member.[90] Upon learning of the allegation, the court separately questioned both members of the jury and allowed the lawyers for both parties to do the same.[91] After dismissing the jurors, the court concluded the alternate juror's allegation was a case of mistaken identity.[92]

Nevertheless, the defendant's counsel objected to the juror's continued presence on the jury, arguing "he's compromised."[93] However, because the juror was the second alternate and was likely to be excused from the jury's deliberations, the court did not dismiss him.[94] The judge then informed the jury that "an allegation of attorney/juror contact had been raised" and, though he failed to mention that the report was inaccurate, the trial proceeded.[95]

The defendant argued the court's statements exposed the jury to extraneous information that prejudiced him.[96] Specifically, the defendant argued that by failing to explain to the jury that the accusation was false, the judge could have caused the jury to conclude that the court believed the accusation was true and, hence, made them biased against him.[97] The defendant asked the court "to order a new trial or remand this case for a determination regarding the extent of any jury bias."[98]

b. Decision

The Tenth Circuit, relying on the decisions in *Mattox* and *Remmer*, reiterated its belief that when members of a jury are exposed to extraneous information, there is an automatic presumption of prejudice.[99] Moreover, the presumption weighs heavily in favor of the defendant and the burden of proving the exposure to extraneous information was harmless falls solely upon the government.[100]

The court noted that the Tenth Circuit and others have questioned the appropriate breadth of *Remmer's* presumption of prejudice, arguing the standard should either be significantly narrowed or replaced altogether.[101] In *United States v. Greer*,[102] for example, the Tenth Circuit itself concluded Federal Rule of Evidence 606(b) may require that courts narrow the *Remmer* presumption.[103] Furthermore, in *United States v.*

90. *Id.* at 1279.
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.* at 1279-80.
97. *Id.* at 1280.
98. *Id.*
99. *Id.*
100. *Id.*
101. *Id.* at 1280 n.5.
102. 620 F.2d 1383 (10th Cir. 1980).
103. *Scull*, 321 F.3d at 1280 n.5 (noting *Greer*, 620 F.2d at 1385 n.1).

Sylvester,[104] the Fifth Circuit argued the *Remmer* standard could not survive *Phillips* and *Olano*, under which *Remmer's* presumption of prejudice is no longer automatic, but rather determined at the trial court's discretion.[105] Likewise in *United States v. Williams-Davis*,[106] the D.C. Circuit argued the Supreme Court's decisions in *Phillips* and *Olano* have diminished the presumption of prejudice and given the trial court broad discretion to assess the effect of alleged intrusions.[107]

Nevertheless, the court stated that in the absence of Supreme Court authority to the contrary, it would review the defendant's claim "under *Remmer's* rubric."[108] While there was an overwhelming amount of evidence to support the defendant's guilt, the defendant did not present any evidence that the court's statements regarding the alleged attorney/juror contact tainted the jury.[109] Accordingly, the court concluded that the district court did not plainly err by failing to take further steps to determine the existence of jury bias.[110]

B. The D.C. Circuit

While the Tenth Circuit has steadfastly maintained the validity of the Remmer presumption, various other circuits have either narrowed its applicability in response to the Supreme Court's decisions in Phillips and Olano and the enactment of Rule 606(b) of the Federal Rules of Evidence, or abandoned it altogether.[111] The following cases, mentioned in Scull, illustrate the divergent views among the Federal Circuits over the question of whether the Remmer presumption remains good law.

1. *United States v. Williams-Davis*[112]

a. Facts

In *Williams-Davis*, the defendants were found guilty of conspiring to distribute and possess with intent to distribute illegal drugs.[113] After the verdicts were returned, the district court granted the defense counsel permission to speak with the jurors.[114] The defendants returned to court shortly thereafter, filing a motion to dismiss or, alternatively, for a new

104. 143 F.3d 923 (5th Cir. 1998).
105. *Scull*, 321 F.3d at 1280 n.5 (noting *Sylvester*, 143 F.3d at 933).
106. 90 F.3d 490 (D.C. Cir. 1996).
107. *Scull*, 321 F.3d at 1280 n.5 (noting *Williams-Davis*, 90 F.3d at 496).
108. *Id.*
109. *Id.* at 1281.
110. *Id.*
111. *See Sylvester*, 143 F.3d at 933-34 (arguing *Remmer* standard was reconfigured by *Phillips* and *Olano*); *Williams-Davis*, 90 F.3d at 496 (questioning the appropriate breadth of *Remmer* and suggesting that the District of Columbia Circuit no longer treats the presumption as "particularly forceful"); *see also* United States v. Pennell, 737 F.2d 521, 532 (6th Cir. 1984) (arguing that the *Remmer* presumption should be abandoned altogether).
112. 90 F.3d 490 (D.C. Cir. 1996).
113. *Williams-Davis*, 90 F.3d at 493.
114. *Id.* at 494.

trial based on affidavits from four jurors claiming numerous instances of juror misconduct.[115] In their affidavits, the jurors asserted that the forewoman said her husband told her to "nail" the defendants.[116] On appeal, the defendants argued "first that prejudice must be presumed, and second that the judge should have held a more extensive hearing."[117]

b. Decision

The District of Columbia Circuit ("D.C. Circuit") concluded that *Phillips* and *Olano* had significantly narrowed the *Remmer* standard.[118] By assuring the defendant "'an opportunity to prove actual bias,'" the *Phillips'* decision was inconsistent with the *Remmer* presumption, under which a defendant would not need an opportunity to prove the jury was in some manner biased.[119]

Furthermore, the D.C. Circuit read *Olano* as backing away from the *Remmer* presumption, viewing *Remmer* as simply "a case illustrating the importance of *weighing the likelihood* of prejudice rather than as a source of rigid rules."[120] The court also noted that, although often referring to *Remmer*, the D.C. Circuit has "not treated the supposed 'presumption' as particularly forceful," and places more discretion with the trial court to determine if jury exposure to extraneous information was prejudicial.[121] Accordingly, the district court was correct to "inquire whether any particular intrusion showed enough of a 'likelihood of prejudice' to justify assigning the government a burden of proving harmlessness."[122] "[W]here the court conducts an inquiry broad enough to lead it to a reasonable judgment that there has been no prejudice . . . it has fulfilled its procedural as well as its substantive duty."[123]

C. The Fifth Circuit

1. *United States v. Sylvester*[124]

a. Facts

In *Sylvester*, a Fifth Circuit court convicted the defendants of assorted drug-related crimes.[125] During the course of the trial, "[t]here were three separate instances of potential jury tampering."[126] The first two

115. *Id.*
116. *Id.* at 495.
117. *Id.*
118. *Id.* at 496.
119. *Id.* (quoting Smith v. Phillips, 455 U.S. 209, 215 (1982)).
120. *Id.*
121. *Id.* at 496-97.
122. *Id.* at 497.
123. *Id.* at 499.
124. 143 F.3d 923 (5th Cir. 1998).
125. *Sylvester*, 143 F.3d at 926.
126. *Id.* at 931.

involved unknown persons contacting members of the jury at home and asking them to discuss the case.[127] The third instance of potential jury tampering was raised in an *ex parte* meeting between the district court judge and a particular jury member who reported that a concession stand vendor at the courthouse had implored her to "take it easy on the brothers."[128] On appeal, the defendants contended that: 1) the district court erred by conducting *ex parte voir dire* with individual jurors during its investigation of jury tampering; and 2) the government was automatically required to prove the absence of prejudice.[129]

b. Decision

The Court of Appeals held that the district court abused its discretion in conducting the *ex parte voir dire*.[130] To begin with, when the possibility of outside influence on the jury arises, "'the failure to hold a hearing in such a situation constitutes an abuse of discretion and is reversible error.'"[131] Moreover, after *Remmer*, the court noted, the Fifth Circuit consistently required the inclusion of all parties in such hearings.[132]

In addition, the court concluded that the government is not automatically required to prove the absence of prejudice.[133] While *Remmer* held that any outside influence on the jury was presumptively prejudicial and the burden fell on the government to rebut this presumption, the Supreme Court since has backed away from this position.[134] Like the D.C. Circuit did in *Williams-Davis*, the Fifth Circuit concluded that the *Remmer* presumption could not survive the Supreme Court's subsequent decisions in *Phillips* and *Olano*, which indicated that the presumption of prejudice and the assignment of the burden of proof are not triggered automatically but are imposed at the discretion of the district court.[135]

In *Phillips*, the Supreme Court stated it had "'long held that the remedy for allegations of juror partiality is a hearing in which the *defendant* has the opportunity to prove actual bias.'"[136] This language, the Fifth Circuit maintained, was "difficult to reconcile with a presumption of prejudice warranting rebuttal by the government" because if such a presumption indeed existed, why would a defendant need to prove actual bias?[137]

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127. *Id.* at 931-32.
128. *Id.* at 932.
129. *Id.* at 931, 933.
130. *Id.* at 932.
131. *Id.* (quoting United States v. Webster, 750 F.2d 307, 338 (5th Cir. 1984)).
132. *Id.*
133. *Id.* at 933.
134. *Id.*
135. *Id.*
136. *Id.* at 934 (quoting *Remmer*, 455 U.S. at 215) (emphasis added in quotation).
137. *Id.*

Likewise, the Supreme Court's decision in *Olano* further reconfigured *Remmer*.[138] In that case,

> [t]he Court summarized what it termed "intrusion jurisprudence," quoted *Phillips*, and concluded:
>
> > There *may* be cases where an intrusion should be presumed prejudicial, but a presumption of prejudice as opposed to a specific analysis does not change the ultimate inquiry: Did the intrusion affect the jury's deliberations and thereby its verdict?[139]

Thus, if the court determines that prejudice is likely, only then may it require the government to prove otherwise.[140] This rule, the court held, comported with the Fifth Circuit's "longstanding recognition of the trial court's considerable discretion in investigating and resolving charges of jury tampering."[141]

D. The Sixth Circuit

1. *United States v. Pennell*[142]

a. Facts

Finally, in *Pennell*, United States District Court for the Eastern District of Michigan convicted the defendant of "one count of conspiracy to possess with intent to distribute cocaine, one count of attempt to possess with intent to distribute cocaine, seven counts of unlawful use of a communications facility, and one count of unlawful carrying of a firearm during the commission of a felony."[143] Two days after deliberations began, five jurors received anonymous phone calls.[144] In all five instances, the caller urged the juror to find the defendant guilty and then quickly hung up.[145] On appeal, the defendant contended that the trial court should have declared a mistrial.[146]

b. Decision

The Sixth Circuit explicitly construed *Phillips* as working "a substantive change in the law,"[147] eliminating any presumption of prejudice

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138. *Id.*
139. *Id.* (quoting United States v. Olano, 507 U.S. 725, 739 (1993)) (emphasis added in quotation).
140. *Id.*
141. *Id.*
142. 737 F.2d 521 (6th Cir. 1984).
143. *Pennell*, 737 F.2d at 523 (citations omitted).
144. *Id.* at 529.
145. *Id.*
146. *Id.*
147. *Id.* at 532 n.10.

and placing the burden on the defendant to show prejudice.[148] The court read *Phillips* as holding that "*Remmer* does not govern the question of the burden of proof where potential jury partiality is alleged."[149] Rather, *Remmer* simply provided that a hearing must be held, where the defendant could present evidence, to determine the effects of such alleged conduct on the jury's deliberations.[150]

Moreover, the district court's decision should be reviewed solely for abuse of discretion and "deference should be accorded [to] . . . findings made after a properly conducted hearing . . . ."[151] Because the district court appropriately conducted a hearing to determine whether the partiality of the five juror members had been compromised, and in view of "the jurors' repeated assertions of unimpaired impartiality," the district court did not abuse its discretion in denying the defendant's motion for a new trial.[152]

III. ANALYSIS

Unauthorized communications with members of the jury about the matter pending before them violates a criminal defendant's Sixth Amendment right to an impartial jury, and can result in a mistrial.[153] Whether the United States Supreme Court's decisions in *Mattox* and *Remmer* remain good law,[154] and a presumption of prejudice still exists, or whether the adoption of Federal Rule of Evidence 606(b) and intervening decisions of the Court have implicitly overruled them,[155] is, thus, an important question with significant implications.

Rule 606(b) prohibits juror testimony as to the effect of any extraneous prejudicial information or outside influence on the juror's state of mind to impeach a verdict.[156] The policy behind this rule is to discourage harassment of jurors, insulate the jury room to facilitate free and open discourse, and reduce opportunity and incentive for jury tampering.[157] Some argue that Rule 606(b) makes it difficult, if not impossible, for the government to prove post trial that the alleged misconduct did not affect the verdict.[158] However, Rule 606(b) does not foreclose testimony by

148. *Id.* at 532.
149. *Id.*
150. *Id.*
151. *Id.* at 532.
152. *Id.* at 534.
153. John P. Faggiano, *Criminal Law – Potential Witness' Casual Conversation With Jurors Held Harmless to Defendant* – United States v. O'Brien, 972 F.2d 12 (1st Cir. 1992), 27 SUFFOLK U. L. REV. 1090, 1090 (1993).
154. *See supra* note 6 and accompanying text.
155. *See supra* note 7 and accompanying text.
156. 5 WAYNE R. LAFAVE ET AL., CRIMINAL PROCEDURE § 24.9(f) (2d ed. 1999).
157. Developments in the Law, *Racist Juror Misconduct During Deliberations*, 101 HARV. L. REV. 1595, 1599 (1988); *see* Tanner v. United States, 483 U.S. 107, 119-20 (1987) (quoting McDonald v. Pless, 238 U.S. 264, 267-68 (1915)).
158. 5 LAFAVE ET AL., *supra* note 156, § 24.9(f).

jurors as to prejudicial extraneous information or other outside influences brought to bear upon the deliberative process.[159] Thus, a juror may testify as to statements by the bailiff or the introduction of a prejudicial newspaper account into the jury room,[160] and "there is little doubt that the exception applies in a case where the jurors have been provided with prejudicial information not admitted into evidence."[161]

Furthermore, in *Phillips*, "the Court stated that the remedy for jury misconduct was 'an opportunity' for the *defendant* 'to prove actual bias.'"[162] Accordingly, an increasing number of lower courts now require the defendant to demonstrate some "likelihood of prejudice" before the court assigns the government the burden of proving harmlessness.[163] However, other federal appellate courts continue to uphold *Remmer's* statement of the legal standard for evaluating the effect of an improper contact with a juror.[164] In particular, the United States Court of Appeals for the Fourth Circuit distinguished *Phillips* from the improper juror contact issue involved in *Remmer* on the grounds that *Phillips* involved an allegation of intrinsic juror bias, which may be revealed during *voir dire*.[165] While *Phillips* stands for the proposition that even though it is improper in certain cases to impute prejudice where procedures have been used to protect the defendant's rights, the use of such a presumption was not foreclosed in appropriate circumstances.[166] In fact, Justice O'Connor, in her concurring opinion, expressed her view that a presumption of prejudice still exists for certain egregious cases.[167]

In addition, some have interpreted *Olano* as having in some way reconfigured the *Remmer* presumption.[168] As discussed above, based in part on *Olano*, the court in *Williams-Davis* rejected *Remmer's* automatic presumption, and concluded that a district court should instead "inquire whether any particular intrusion showed enough of a 'likelihood of prejudice' to justify assigning the government a burden of proving harmlessness."[169] However, the *Olano* court, itself, rejected such a broad preclusion, stating "[t]here may be cases where an intrusion should be presumed prejudicial . . . ."[170] While *Phillips* and *Olano* may arguably have narrowed the scope of presumptive prejudice, they did not "preclude

159. *See* FED. R. EVID. 606(b).
160. Mattox v. United States, 146 U.S. 140, 149 (1892).
161. James W. Diehm, *Impeachment of Jury Verdicts:* Tanner v. United States *and Beyond*, 65 ST. JOHN'S L. REV. 389, 422 (1991).
162. 5 LAFAVE ET AL., *supra* note 156, § 24.9(f); *see also* Smith v. Phillips, 455 U.S. 209, 215 (1982).
163. 5 LAFAVE ET AL., *supra* note 156, § 24.9(f).
164. *Phillips*, 455 U.S. at 215.
165. *See* Haley v. Blue Ridge Transfer Co., 802 F.2d 1532, 1535 n.5 (4th Cir. 1986).
166. *See* Jenkins v. State, 825 A.2d 1008, 1024 (Md. 2003).
167. *Phillips*, 455 U.S. at 221-22.
168. *See* United States v. Williams-Davis, 90 F.3d 490, 496 (D.C. Cir. 1996); *see also* United States v. Sylvester, 143 F.3d 923, 934 (5th Cir. 1998).
169. *William-Davis*, 90 F.3d at 497.
170. United States v. Olano, 507 U.S. 725, 739 (1993).

such a presumption in all situations, *i.e.*, where excessive or egregious jury misconduct or improper contact by a third party occurs."[171]

CONCLUSION

Even if the fundamental principles of *Mattox* and *Remmer* have been in some form limited by the Supreme Court's decisions in *Phillips* and *Olano*, until overruled, the federal circuit courts must continue to apply them where they are directly applicable.[172] Because only some federal courts continue to adhere to those cases, the Supreme Court should exercise its *certiorari* jurisdiction and decide this matter once and for all.[173]

Fundamental to the American criminal justice system is the principle, embedded in the Constitution of the United States, that "every person accused of a crime is entitled to be tried by a fair and impartial jury of his peers and to be convicted, if at all, on the basis of evidence properly adduced at trial."[174] It remains critical, as Chief Justice Fuller first declared in 1892, that "the jury should pass upon the case free from external causes tending to disturb the exercise of deliberate and unbiased judgment. Nor can any ground of suspicion that the administration of justice has been interfered with be tolerated."[175] Accordingly, while the Supreme Court may be willing to limit the application of the *Remmer* presumption to those instances of jury misconduct or improper third party contact that are particularly egregious, it will likely not abandon the presumption entirely.

The Tenth Circuit Court of Appeal's decisions on this matter, though bound by those of the Supreme Court, indicate a willingness to consider narrowing and/or modifying the *Remmer* presumption. However, absent Supreme Court authority to the contrary, the Tenth Circuit is correct in continuing its application.

*Bradley Tennyson Smith**

171. *Jenkins*, 825 A.2d at 1026.

172. Petition for Writ of Certiorari at 30, Exxon Mobile Corp. v. Baker, 531 U.S. 919 (2000) (No. 00-90).

173. *Id.*

174. Andrea G. Nadel, J.D., *Juror's Reading of Newspaper Account of Trial in Federal Criminal Case During Its Progress as Ground for Mistrial, New Trial, or Reversal*, 85 A.L.R. FED. 13, § 2 (1987).

175. *Mattox*, 146 U.S. at 149.

* J.D. Candidate, 2005, Denver University College of Law.